

# ACRP

REPORT 66

AIRPORT  
COOPERATIVE  
RESEARCH  
PROGRAM

## Considering and Evaluating Airport Privatization

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**ACRP REPORT 66**

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**Considering and Evaluating  
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## AIRPORT COOPERATIVE RESEARCH PROGRAM

Airports are vital national resources. They serve a key role in transportation of people and goods and in regional, national, and international commerce. They are where the nation's aviation system connects with other modes of transportation and where federal responsibility for managing and regulating air traffic operations intersects with the role of state and local governments that own and operate most airports. Research is necessary to solve common operating problems, to adapt appropriate new technologies from other industries, and to introduce innovations into the airport industry. The Airport Cooperative Research Program (ACRP) serves as one of the principal means by which the airport industry can develop innovative near-term solutions to meet demands placed on it.

The need for ACRP was identified in *TRB Special Report 272: Airport Research Needs: Cooperative Solutions* in 2003, based on a study sponsored by the Federal Aviation Administration (FAA). The ACRP carries out applied research on problems that are shared by airport operating agencies and are not being adequately addressed by existing federal research programs. It is modeled after the successful National Cooperative Highway Research Program and Transit Cooperative Research Program. The ACRP undertakes research and other technical activities in a variety of airport subject areas, including design, construction, maintenance, operations, safety, security, policy, planning, human resources, and administration. The ACRP provides a forum where airport operators can cooperatively address common operational problems.

The ACRP was authorized in December 2003 as part of the Vision 100-Century of Aviation Reauthorization Act. The primary participants in the ACRP are (1) an independent governing board, the ACRP Oversight Committee (AOC), appointed by the Secretary of the U.S. Department of Transportation with representation from airport operating agencies, other stakeholders, and relevant industry organizations such as the Airports Council International-North America (ACI-NA), the American Association of Airport Executives (AAAE), the National Association of State Aviation Officials (NASAO), Airlines for America (A4A), and the Airport Consultants Council (ACC) as vital links to the airport community; (2) the TRB as program manager and secretariat for the governing board; and (3) the FAA as program sponsor. In October 2005, the FAA executed a contract with the National Academies formally initiating the program.

The ACRP benefits from the cooperation and participation of airport professionals, air carriers, shippers, state and local government officials, equipment and service suppliers, other airport users, and research organizations. Each of these participants has different interests and responsibilities, and each is an integral part of this cooperative research effort.

Research problem statements for the ACRP are solicited periodically but may be submitted to the TRB by anyone at any time. It is the responsibility of the AOC to formulate the research program by identifying the highest priority projects and defining funding levels and expected products.

Once selected, each ACRP project is assigned to an expert panel, appointed by the TRB. Panels include experienced practitioners and research specialists; heavy emphasis is placed on including airport professionals, the intended users of the research products. The panels prepare project statements (requests for proposals), select contractors, and provide technical guidance and counsel throughout the life of the project. The process for developing research problem statements and selecting research agencies has been used by TRB in managing cooperative research programs since 1962. As in other TRB activities, ACRP project panels serve voluntarily without compensation.

Primary emphasis is placed on disseminating ACRP results to the intended end-users of the research: airport operating agencies, service providers, and suppliers. The ACRP produces a series of research reports for use by airport operators, local agencies, the FAA, and other interested parties, and industry associations may arrange for workshops, training aids, field visits, and other activities to ensure that results are implemented by airport-industry practitioners.

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The members of the technical panel selected to monitor this project and to review this report were chosen for their special competencies and with regard for appropriate balance. The report was reviewed by the technical panel and accepted for publication according to procedures established and overseen by the Transportation Research Board and approved by the Governing Board of the National Research Council.

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This guidebook (the “Guidebook”) was prepared as part of ACRP Project 01-14 by a research team of recognized experts in airport business, finance, governance, law, and privatization. LeighFisher was the primary research consultant. Sheri Ernico, Director at LeighFisher, was the Principal Investigator. The other authors were Steve Van Beek of LeighFisher/Eno Transportation Foundation for the emerging domestic issues and policy matters; Dan Reimer of Kaplan Kirsch & Rockwell LLP on the regulatory and policy framework; Simon Morris, Richard Sharp, and Jessica Dahlstrom of LeighFisher on international airport privatization; Phil Bates of LeighFisher on the non-airport privatization in the U.S. transport sector; Bruce Boudreau of LeighFisher who contributed to conceptual content; Matt Townsend of LeighFisher who assisted in the JFKIAT and Indianapolis case studies; Dave Vondle of Vondle & Associates who assisted on the Stewart International Airport case study; and Ann Graham of the University of Westminster who assisted with the literature search and reviewed the international airport privatization chapter.

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# FOREWORD

By **Theresia H. Schatz**

Staff Officer

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*ACRP Report 66: Considering and Evaluating Airport Privatization* is a guidebook that assists airport operators, policy makers, and other relevant stakeholders as they consider and analyze the potential advantages and disadvantages of implementing various approaches to airport privatization. The guidebook covers a range of potential privatization options, from service contracts to private airport ownership or development. In addition, the guidebook includes case studies conducted at a variety of airports both within the United States and internationally.

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Interest in airport privatization is increasing, especially as local and regional governments look for ways to make their airports as efficient, competitive, and financially viable as possible. Consideration by communities, governing boards, airport officials, and other stakeholders on whether to privatize all or part of an airport is a significant decision with long-term impacts. As such, the decision-making process must ensure that a thorough and complete review is undertaken, so financial and other implications of privatization are fully understood and, hence, an informed, transparent decision can be made. Private-sector participation in airports—through ownership, operation, management, or new investment programs—can take many forms, including outsourcing certain functions; management contracts; public-private partnership (P3) agreements; design-build-finance-operate developments; outright sale or long-term lease of assets; and other private finance initiatives. Full airport privatization has been adopted or considered in various forms at many foreign airports but only at a limited number of U.S. airports while a wide range of partial airport privatization has existed at U.S. airports for many years.

The Airport Privatization Pilot Program, under 49 U.S.C. Section 47134, provides a limited number of airports in the United States with a special vehicle for full airport privatization, including certain exceptions from existing legal disincentives, and continues to generate discussion among airport operators and owners, governing boards, and airport officials. Although there have been a number of applications for the program since it was created in 1996, only one applicant completed the process as of this publication (Stewart International Airport), which subsequently reverted back to public operation. As the discussion of these issues continues, U.S. airport stakeholders can benefit from an objective presentation of the international experience with airport privatization and the relative advantages and disadvantages of privatization for U.S. airports.

This report was developed under ACRP Project 01-14. Also contained in the guidebook are Appendices A and B; Appendices C through H, which provide additional background information as part of the research conducted in preparing the guidebook, are on the CD.

It is understood that the research was concluded as of December 2011 and there are currently some federal regulatory changes being contemplated. For example, the FAA is currently revisiting its policy on the issue of waiving the repayment of federal grants for airports privatized outside the Airport Privatization Pilot Program. Please keep in mind, there are several references in the guidebook with respect to this one issue for full privatization outside the APPP that could be impacted by the FAA's contemplated change in Order 5190.6B. It is recommended that the user of the guidebook reference the most current legislation and policy in place at the time.



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Note: Many of the photographs, figures, and tables in this report have been converted from color to grayscale for printing. The electronic version of the report (posted on the Web at [www.trb.org](http://www.trb.org)) retains the color versions.

## CHAPTER 1

# Summary

### 1.1 Purpose and Objectives of Guidebook

Local and regional governments continue to look for ways to make their airports as efficient, competitive, and financially viable as possible, as well as ways to maximize the community's return from their airport assets. Communities have and continue to promote private sector participation in airports in pursuit of these goals. Consideration by communities, governing boards, airport officials, airlines, investors, and other stakeholders on whether to enlist or expand private sector participation in an airport can be a significant decision with long-term consequences.

The objective of this research is to develop a guidebook on airport privatization that assists U.S. airport owners, policy makers, and other relevant stakeholders as they consider and analyze the potential advantages and disadvantages of implementing various approaches to airport privatization. The guidebook is intended to be a comprehensive resource that summarizes in a concise and easy-to-understand format the various options for private sector involvement in the operation, management, and financing of airports in the United States and provide the tools necessary to evaluate such options to make sound decisions about potential privatization initiatives.

Because the goals, objectives, opportunities, strategic priorities, and challenges differ from one airport sponsor to another, each situation should be evaluated on its own merits. Moreover, the decision to privatize is often made in a broader context by the policy makers or the airport owner.

Privatization does not have to be an all-or-nothing solution; the airport owner can choose to privatize portions of an airport's management and operation. The guidebook identifies and outlines realistic options and highlights a variety of successful and unsuccessful privatization initiatives through case studies examples. The decision matrix in the guidebook helps a community and an airport owner identify and evaluate

the appropriate ways to enlist the support of the private sector given its unique situation.

### 1.2 Privatization Motivations and Drivers

The potential benefits of airport privatization have been identified to include: (1) access private capital for development, (2) extract an upfront or ongoing payment for the airport asset (monetize the asset), (3) stimulate air service and airline competition, (4) introduce more innovation and creativity, including entrepreneurial ideas in the development of nonairline revenue, (5) secure long-term efficiencies in operation and maintenance and enhance customer service, (6) shift the risk of debt, capital development, and/or operations to the private sector, (7) accelerate project delivery and reduce construction costs, (8) reduce reliance on general tax levies, and (9) de-politicize airport decision making (Figure 1.1).

### 1.3 Generic Privatization Models

Privatization refers to the shifting of governmental functions, responsibilities, control, and in some cases ownership, in whole or in part, to the private sector. The term "airport privatization" is often understood to mean the transfer of an entire airport to private operation and/or ownership, but private sector involvement at airports can take many forms.

Figure 1.2 illustrates the potential range of strategies available for private sector participation in airport management, operation, and development under four generic privatization models. The range extends from the least level of private involvement to the most private sector involvement. A critical distinction is made between:

- **Partial Privatization**—Partial privatization refers to strategies where partial control and at least a portion of ownership remains with the public owner.

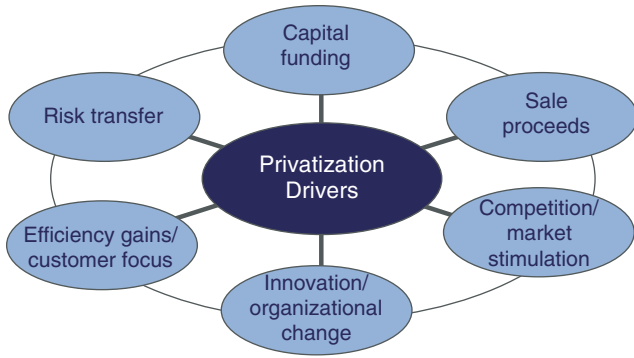


Figure 1.1. Key motives to privatize.

- Full Privatization—Full privatization refers to strategies where the complete control and/or operation of an entire airport are vested with a private entity through a long-term lease or sale (either under or outside the Airport Privatization Pilot Program or APPP).<sup>1</sup>

## 1.4 Examples of Specific Strategies

Figure 1.3 shows examples for specific strategies within each privatization model, which are presented in more detail in each respective chapter.

### 1.4.1 Service Contracts

Contracting services or outsourcing refers to the delegation of non-core operations from the public sector to a private entity that specializes in the operation, maintenance, or management of that activity. Although most U.S. airports outsource at least some services or functions, a number of airports have been considering more extensive opportunities for outsourcing of functions such as fire services currently provided by many municipal departments.

Examples for outsourcing services are shown in Table 1.1.

### 1.4.2 Management Contracts

Airport owners can contract out the management and operation of parking facilities, terminal concessions, ter-

<sup>1</sup>The Airport Privatization Pilot Program was created to test a new method for increasing private participation, and especially private capital, in airport operations and development. Through legislation enacted in 1996 and amended in 2003 and 2012, Congress lowered several barriers to privatization that had been identified during a debate on the subject, including the prohibition on revenue diversion. Congress limited the scope of the program and imposed certain conditions on approval, and the FAA later adopted procedural requirements for applicants seeking to participate in the program. Please see Chapter 6 for a detailed description.

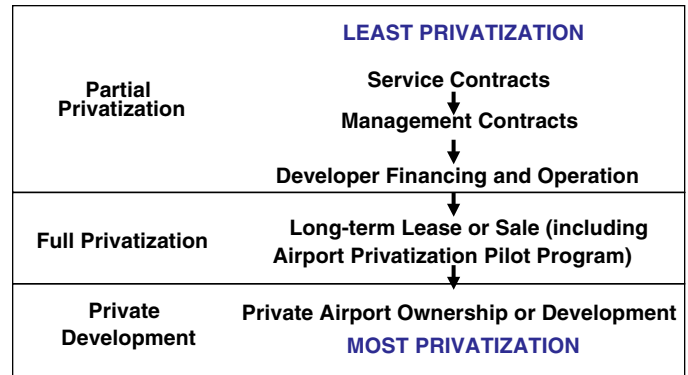


Figure 1.2. Airport privatization continuum generic models.

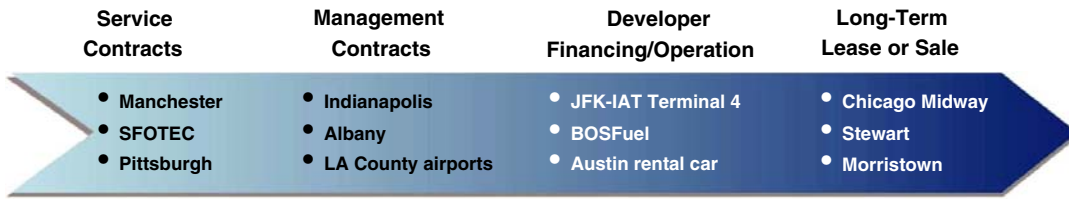
minal operations, reliever airports, or their entire airport system to private operators. Management contracts for parking operations are particularly prevalent. Contracts for the management of an airport or airport system exist at large and small facilities. At general aviation airports, the airport management company also may serve as the fixed-base operator, providing aeronautical products and services to airport tenants and users.

An example of the allocation of responsibilities and control for a full airport system management contract can be found in the Indianapolis Airport Authority case study (see Chapter 9 and Appendix H). The scope of services for the Indianapolis contractor was organized into three components, with functions as summarized in Table 1.2.

In Indianapolis, the contractor was charged with administering and enforcing all agreements maintained by the airport authority, subject to the policy decisions of the board. The contractor was responsible for managing the implementation of capital improvements, subject to approval by the board and any other responsible parties (e.g., the FAA) in compliance with all governmental regulations.

The airport authority retained under its control the following functions:

- Airline use agreement compliance
- Compliance with the authority's obligations under the law and under federal grant agreements
- Air service development policy
- Debt issuance policy
- Rates and charges policy
- Long-range planning
- Land acquisition and development policy and planning
- Airport industrial and economic development policy
- Environmental policy
- Capital expenditure policy and implementation of capital improvements



Cost Reduction Specialized Expertise	Management Expertise	Capital Investment	Upfront Payment Exit Airport Business
<ul style="list-style-type: none"> <li>• Cleaning/janitorial</li> <li>• Conveyance systems</li> <li>• ARFF</li> <li>• Security guards</li> <li>• Common use equipment</li> <li>• Parking operations</li> <li>• Terminal concessions</li> <li>• Commercial land development</li> </ul>	<ul style="list-style-type: none"> <li>• Specific facility (e.g., parking)</li> <li>• Airport-wide management</li> </ul>	<ul style="list-style-type: none"> <li>• Terminal development</li> <li>• Fuel systems</li> <li>• Cargo</li> <li>• Rental car</li> <li>• General aviation</li> <li>• Solar</li> </ul>	<ul style="list-style-type: none"> <li>• Airport Privatization Pilot Program</li> <li>• Long-term lease for full operation and development</li> </ul>

Figure 1.3. Examples of privatization strategies.

Table 1.1. Examples of outsourced services.

Traditional	Less Typical
<ul style="list-style-type: none"> <li>▪ Maintenance services (e.g., janitorial, window cleaning, landscaping)</li> <li>▪ Conveyance systems (e.g., elevators, escalators, moving walkways)</li> <li>▪ Mechanical systems (e.g., HVAC)</li> <li>▪ Airline equipment (e.g., baggage systems, jetways, pre-conditioned air, common use equipment)</li> <li>▪ People mover systems</li> <li>▪ Shuttle bus operations</li> <li>▪ Financial planning</li> <li>▪ Financial advisory</li> <li>▪ Planning studies (e.g., master plans)</li> <li>▪ Architectural, engineering, design</li> <li>▪ Construction inspection</li> <li>▪ Construction management</li> <li>▪ Program management</li> </ul>	<ul style="list-style-type: none"> <li>▪ Terminal concession management</li> <li>▪ Commercial land development agents</li> <li>▪ Aircraft rescue and firefighting services (ARFF)</li> <li>▪ Law enforcement</li> <li>▪ Security guards</li> </ul>

Table 1.2. Airport-wide management contract responsibilities at Indianapolis.

Terminal Services	Airfield Support Services	Administrative Support Services
<ul style="list-style-type: none"> <li>▪ Terminal maintenance and janitorial</li> <li>▪ Terminal operation</li> <li>▪ Terminal concessions</li> <li>▪ Parking and rental car</li> <li>▪ Terminal advertising</li> <li>▪ Grounds maintenance</li> <li>▪ Terminal security</li> <li>▪ Planning and engineering for terminal</li> <li>▪ Terminal land development</li> </ul>	<ul style="list-style-type: none"> <li>▪ Airfield maintenance/snow removal</li> <li>▪ Ramp operations</li> <li>▪ Airfield signage/navigation</li> <li>▪ Fire and rescue</li> <li>▪ Reliever and general aviation airports and heliport</li> <li>▪ Non-terminal buildings maintenance</li> <li>▪ FBO and general aviation facilities maintenance</li> <li>▪ Vehicle maintenance</li> <li>▪ Intermodal and cargo support</li> <li>▪ Airfield planning and engineering</li> <li>▪ De-icing</li> <li>▪ Airside land development</li> <li>▪ Airside security</li> <li>▪ Fuel farms and fill stands</li> </ul>	<ul style="list-style-type: none"> <li>▪ Finance and accounting</li> <li>▪ Grant management</li> <li>▪ Management information systems</li> <li>▪ Public relations, including noise abatement programs</li> <li>▪ Human resources management</li> <li>▪ Purchasing and contracts management</li> <li>▪ Administration of bond issuance</li> <li>▪ Administration of PFC collection and accounting</li> <li>▪ Land acquisition and relocation implementation</li> <li>▪ Legal</li> <li>▪ Air service marketing, including freight</li> </ul>

**Table 1.3. Alternative strategies for developer financing and operation.**

Approach	Design	Build	Operate & Maintain	Finance	Transfer at End of	
					Construction	Lease
Construction Manager at Risk	◆	◆			◆	
Design-Build-Operate-Maintain	◆	◆	◆			◆
Build-Transfer-Operate		◆	◆		◆	
Build-Operate-Transfer		◆	◆	◆		◆
Design-Build-Operate-Transfer	◆	◆	◆			◆
Design-Build-Operate-Maintain and Finance	◆	◆	◆	◆		◆

### 1.4.3 Developer Financing and Operation

There is a wide variety of developer financing and operation employed in the United States, including passenger terminals, parking garages, rental car facilities, fuel systems, cargo facilities, general aviation facilities, and other major facilities. The private sector can provide full-scale development, operation, and maintenance services and sometimes financing under long-term leases or concessions. Table 1.3 illustrates the range of project development privatization models with different degrees of control and risk for the airport owner.

Variations and examples of the Design-Build-Operate-Maintain and Finance approach for airports include:

- Public-Private Partnership for Terminal Development (e.g., JFKIAT Terminal 4)
- Single Tenant Special Facility Terminal Lease (e.g., Terminal A at Boston)
- Multi-Tenant Special Facility Terminal Lease (e.g., Terminal 5 at Chicago O’Hare)
- Special Facility Fuel System Leases (e.g., San Francisco)
- Second Party Cargo Development (e.g., Memphis)
- Third Party Cargo Development (e.g., Pittsburgh)
- Private Development of Consolidated Rental Car Facility (e.g., Anchorage)
- Private Parking Development (e.g., Hartford)
- Private Solar Development (e.g., Austin)

### 1.4.4 Full Privatization—Long-Term Lease or Sale

Under the full privatization models, the airport owner enters into a long-term lease, long-term concession, or sale of an airport, which can be accomplished under the APPP or outside of the APPP. It is important to make a distinction between the main participants in this type of transaction—namely, the private entity that will be responsible for managing and operating the airport and who typically does not make an equity investment, versus the lenders and investors who do invest in the transaction but have no role in day-to-day operations. For purposes of this guidebook, the term “private

operator” is used to refer to an individual private entity or the team selected by the public airport owner to compensate the airport owner for the airport asset and to run the airport.

- Under a long-term lease (or concession agreement), the airport owner grants full management and development control to the private operator in return for the operator undertaking capital improvements and other obligations (e.g., up-front payment, responsibility for outstanding debt, capital improvements).
- Under a sale, the airport is transferred on a freehold basis with the requirement that it continue to be used for airport purposes.

The distinctions between full privatization inside and outside the APPP are described in detail in Chapter 6 and summarized in Table 1.4.

### 1.4.5 Private Airport Development

There are examples of private investors funding the development of an airport without the benefit of federal or state grants. These airports are operated as for-profit businesses. Virtually all of these strategies have been employed for general aviation airports. Branson Airport is the only privately owned commercial passenger airport in the United States. However, private airport development without government support is not considered to be airport privatization for purposes of the guidebook since it does not involve the *transfer* of control or ownership from the public sector to the private sector.

## 1.5 Evaluation of Privatization Strategies

Table 1.5 presents a high level summary of the various opportunities, advantages, and disadvantages of each privatization model, which are presented in more detail in each chapter. The reader should also refer to Tables 8.8 through 8.11 for potential ways to mitigate some of the disadvantages and risks.

**Table 1.4. Comparison of full privatization under the APPP and outside the APPP.**

	<b>Full Privatization Pursuant to Pilot Program (49 USC § 47134)</b>	<b>Full Privatization Outside Pilot Program (FAA Order 5190.6B)</b>
Eligible Airports	No more than 10 airports eligible to participate. Only one slot currently available for a non-large-hub airport.	No cap on number or type of airports.
Use of Sale Proceeds	Public airport sponsor can request FAA approval to use sale proceeds for non-airport purposes. For primary airports, requires consent of 65% of airlines. For nonprimary airports, requires consultation with based aircraft owners.	Sale proceeds must be used for airport purposes.
Grant Repayment	FAA <i>may</i> excuse public airport sponsor from any repayment obligation that may exist.	FAA <i>will</i> excuse public airport sponsor from any repayment obligation that may exist.
AIP – Entitlement	Private operator is eligible for grants from the Entitlement Fund.	Private operator is <i>not</i> eligible for grants from the Entitlement Fund.
Rates and Charges	Rates on airlines may not exceed inflation rate without consent of 65% of airlines. Rates on aircraft owners may not exceed percentage rate increase on airlines.	Rates and charges must be reasonable and not unjustly discriminatory, pursuant to Grant Assurances.
Private Operator’s Charges on Passengers	Private operator is authorized to impose, collect and use a Passenger Facility Charge.	Private operator is authorized to impose charges on passengers, subject to reasonableness and non-discrimination requirements of the Grant Assurances.

**Table 1.5. Evaluation of privatization strategies.**

<b>Opportunities and Advantages</b>	<b>Disadvantages</b>
<b>Service Contracts</b>	
<ul style="list-style-type: none"> <li>▪ Accesses private sector expertise for specialized functions</li> <li>▪ Applies private sector techniques to accelerate project delivery and reduce construction costs for capital improvements</li> <li>▪ Provides potential to cut costs and optimize efficiency and thereby reduce costs to tenants</li> <li>▪ Retains airport oversight of contracts to ensure compliance with airport goals</li> <li>▪ Reduces airport costs for employee salaries and benefits as well as post retirement expenses and liability (pension, medical, etc.)</li> <li>▪ Involves low implementation risk and complexity</li> <li>▪ Allows airport management to focus on core and strategic issues</li> <li>▪ Maintains airport owner control over land uses and facilities</li> </ul>	<ul style="list-style-type: none"> <li>▪ Could involve organizational disruption (i.e., reassignment or termination of existing employees)</li> <li>▪ Could encounter labor resistance in an effort to protect and increase public sector jobs</li> <li>▪ Requires careful monitoring, which can be expensive and time-consuming</li> <li>▪ Presents tension in the outsourcing relationship – the contractor wants to make a profit and the airport owner wants to cut costs</li> </ul>

(continued on next page)

Table 1.5. (Continued).

Opportunities and Advantages	Disadvantages
<b>Management Contracts</b>	
<ul style="list-style-type: none"> <li>▪ Accesses private sector expertise for specialized functions and commercial development</li> <li>▪ Provides potential to cut costs and optimize efficiency and thereby reduce costs to tenants</li> <li>▪ Provides opportunity for airport to be managed and operated as a business</li> <li>▪ Streamlines day-to-day operational decision making</li> <li>▪ Brings increased emphasis on revenue enhancement, commercial, and economic development</li> <li>▪ Provides potential for new revenue/economic development initiatives</li> <li>▪ Can streamline and improve certain processes (e.g., renegotiating nonairline contracts)</li> <li>▪ Furnishes potential to impose contractual obligation for contractor to achieve performance targets</li> <li>▪ Provides opportunity for staff to gain management expertise</li> <li>▪ Reduces ongoing municipal employee compensation, including post retirement expenses (pension, medical, etc.)</li> <li>▪ Provides greater incentives for management and employees to perform better</li> <li>▪ Provides more commercial and operational freedom for contractor</li> </ul>	<ul style="list-style-type: none"> <li>▪ Involves considerable time and effort for the bidding process</li> <li>▪ Could involve buyouts and compensation for existing public workers</li> <li>▪ Could involve organizational disruption (i.e., reassignment or termination of existing employees)</li> <li>▪ Difficult to truly measure efficiencies for the purpose of justifying compensation</li> <li>▪ Can discriminate against government departments competing in managed competition efforts, as regulations generally prevent them from partnering with private firms or guaranteeing performance</li> <li>▪ Requires careful tracking of contract compliance, which can be a time consuming and substantial undertaking for the airport owner</li> <li>▪ Becomes increasingly difficult to attain further improvements and realize the full value of the management fee once initial efficiencies are attained</li> </ul>
<b>Developer Financing and Operation</b>	
<ul style="list-style-type: none"> <li>▪ Accesses private sector expertise for specialized functions and commercial development</li> <li>▪ Reduces reliance on municipal debt and conserves public capital for those areas where public funding is the only alternative</li> <li>▪ Transfers risk exposure for cost overruns, delays, and debt repayment to the private sector</li> <li>▪ Has potential to reduce operating expenses and increase operational efficiencies due to avoidance of public procurement processes and to private sector motivations and incentives</li> <li>▪ Attains the latest technical and managerial expertise for the infrastructure project</li> <li>▪ Applies private sector techniques to accelerate project delivery and reduce construction costs</li> <li>▪ Can enhance commercial development revenues</li> <li>▪ Creates/retains jobs for the local economy</li> <li>▪ Avoids unnecessary risks for airport owner</li> <li>▪ Minimizes or eliminates delays from local procurement policies that tend to delay contract awards</li> <li>▪ Has potential to provide low-cost facilities to tenants (especially when tax-exempt financing is employed)</li> <li>▪ Limits administrative burden of airport and staffing responsibilities for facility financing, bidding, design, construction oversight, marketing, ongoing maintenance, administration, and management</li> <li>▪ Allows airport management to focus on other strategic issues and assets</li> </ul>	<ul style="list-style-type: none"> <li>▪ Involves considerable time and effort for bidding process and negotiation of complex legal documents</li> <li>▪ Requires that the project have a revenue stream to repay the debt</li> <li>▪ Provides airport less control over the project and facility management</li> <li>▪ Loss of control over the development site and future capacity expansion</li> <li>▪ Loss of flexibility to change land uses over period of lease</li> <li>▪ Less control over types of activities and quality and appearance</li> <li>▪ Involves considerable upfront planning, time, and expense</li> <li>▪ Involves moderate implementation risk</li> <li>▪ Less control of facility utilization especially under airline-financed terminals that run the risk of inefficient utilization of gates and associated terminal space</li> <li>▪ Could involve organizational disruption and need to reassign or terminate existing employees</li> <li>▪ Could involve buyouts and compensation for existing public workers</li> <li>▪ Involves long-term risk if the project encounters financial problems, i.e., the airport may need to step in (even though it is not financially obligated to do so) to preserve the use of the facility and associated airport capacity</li> <li>▪ Can expose the airport to political, legal, operational, and financial risk if the transaction is not consummated or if the private entity incurs financial difficulties</li> <li>▪ Involves loss of key revenue streams under parking and cargo privatization</li> </ul>



Table 1.5. (Continued).

Opportunities and Advantages	Disadvantages
<b>Long-term Sale or Lease (Full Privatization)</b>	
<ul style="list-style-type: none"> <li>▪ Creates potential to promote increase in service, commerce, and economic development</li> <li>▪ Secures a lump sum or ongoing lease payments by selling or leasing airport for budgetary relief (“asset monetization”) or for annual payments to government owner</li> <li>▪ Obtains private capital investment for capacity expansion and modernization and reduces need for public investment and debt, particularly in light of the potential loss of tax-exempt financing, real reductions in AIP funding, and no increase in the PFC level</li> <li>▪ Provides ability for the private sector to innovate, introduce operational and technological efficiencies, and create new income streams</li> <li>▪ De-politicizes airport operations and insulates airport from broader public policies</li> <li>▪ Provides flexibility to structure and tailor debt to meet infrastructure needs, including potential to tap foreign markets for financing</li> </ul>	<ul style="list-style-type: none"> <li>▪ Involves significant time, effort, and out-of-pocket expense to undertake (for both the public and private sector)</li> <li>▪ Involves loss of control by policy makers</li> <li>▪ Requires multiple layers of approvals (federal, state, local, tenants, and employees)</li> <li>▪ Can be constrained by existence of airline use and lease agreements</li> <li>▪ Involves limitations on aeronautical rate increases and requires airline approval to take money out of the aviation system, which can be difficult to obtain and can reduce the value of the transaction</li> <li>▪ Tempts elected officials to cash-out value (“borrow against the future”) without necessarily appreciating and understanding the long-term implications to the airport enterprise</li> <li>▪ Involves higher financing costs (for private capital) than public tax-exempt debt</li> <li>▪ Could involve buyouts and compensation for existing public workers</li> <li>▪ Can involve implementation risk in the event the bidder desires to get out of the transaction</li> <li>▪ Can involve loss of control of the airport by the airport owner, which can be mitigated by including performance standards in the lease</li> <li>▪ Affords limited opportunities because many of the largest U.S. airports already operate like commercial enterprises and few of the smaller ones have strong commercial potential</li> <li>▪ May result in a renegotiation of the contract due to changing market conditions, which are next to impossible to foresee, because of the long-term nature of these leases (50-99 years)</li> <li>▪ Creates long-term responsibility for the airport owner to continue to oversee the performance of the privatized operator, and may also require the airport owner to be ready to operate the airport, if needed, in the event of default or bankruptcy</li> <li>▪ Can expose the airport owner to political, legal, operational, and financial risk if the transaction is not consummated or if the private entity incurs financial difficulties</li> <li>▪ May create greater tort liability risk for a private operator than a public operator in the event of, for example, an act of terrorism or aircraft accident, since the private operator would not likely be entitled to same immunities as a public entity</li> <li>▪ Presents potential for controversy in the event of foreign ownership</li> <li>▪ Gives airport owner less control over customer service standards and airport pricing although performance standards can and should be included in the lease</li> <li>▪ May involve less consideration of local policy issues, environmental impacts, and community interests in favor of shareholder and investor interests</li> <li>▪ May receive less local support if the public owner cannot take money out of the aviation system</li> <li>▪ Provides less access to federal grants</li> </ul>

## 1.6 How to Decide Which Strategy Is Best

Each airport owner has different reasons for considering some form of airport privatization. Therefore, it is important to put these goals and objectives into context when consider-

ing which solution may be the most appropriate under the circumstances.

The process for considering various forms of privatization involves a multi-step process starting with identification of the owner’s goals and objectives, familiarization with the specific strategies available, comparison of those goals to



Figure 1.4. Decision tree filter.

those of other stakeholders, identification of ways to mitigate stakeholder risks, review of the transaction's complexity and risk, and valuation of the transaction (Figure 1.4). The key to achieving the highest probability of success is to be both well-informed and rigorous about the evaluation process, while accounting for the diversity of stakeholder views.

Chapter 8 provides a step-by-step process for considering and evaluating different privatization strategies starting with identifying the specific goals and/or the problems to be addressed to allow for an initial screening of the alternatives that are best suited to the situation.

As illustrated in Table 1.6, some techniques do not fit certain goals, in part due to the strictures of federal law and policy.

An important consideration in evaluating potential privatization models is the level of complexity and risk to implement the action. This is particularly important in the public sector where

officials tend to be risk averse. On a scale ranging from the least complex and risky to most complex and risky, the privatization models conceptually can be ranked as shown in Figure 1.5.

As illustrated by the matrix, the further an airport progresses along the privatization continuum, the more complicated, risky, and expensive the effort becomes, and while the stakes get higher, so do the potential rewards. The logic behind these ratings is described in detail in the chapter for each model.

## 1.7 What Makes the U.S. Airport Model Different?

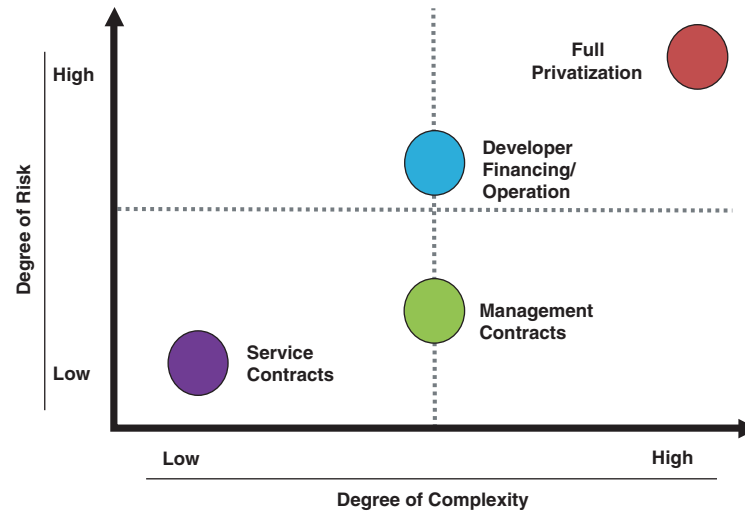
There already is a wide range of strategies employed to enlist the support of the private sector in the management and operation of U.S. airports. Nevertheless, it is often mentioned that full privatization (i.e., full control and/or opera-

Table 1.6. Owner's goals decision tree matrix.

Goals and Objectives	Partial Privatization			Full Privatization <sup>1</sup>	
	Service Contracts	Management Contracts	Developer Financing/ Operation	Inside APPP	Outside APPP
Maintain community control of airport operation and development decisions	X	X			
Secure operating efficiencies	X	X	X	X	X
Introduce innovative revenue enhancements	X	X	X	X	X
Eliminate airport subsidies	X	X		X	X
Reduce airline costs	X				
Convert underutilized facility into economic catalyst		X	X	X	X
De-politicize airport decisions		X	X	X	X
Address identified deficiencies in airport management		X		X	X
Advance ideological interest in private sector participation		X	X	X	X
Address improper conduct, e.g., corruption		X		X	X
Access private capital			X	X	X
Accelerate project delivery			X	X	X
Reduce construction costs			X	X	X
Transfer construction risk			X	X	X
Minimize organizational disruption			X		
Use sale or lease proceeds for non-airport purposes				X*	
Repay airport debt				X	X

\* Only with 65% airline approval at primary airports.

<sup>1</sup> "Full privatization" includes outright sale and long-term lease. For example, the proposed long-term lease of Chicago's Midway would fit in this category. Greenfield private development is not considered privatization.



Source: LeighFisher.

**Figure 1.5. Conceptually assessing complexity and risk.**

tion of an entire airport by a private entity) has become a worldwide trend while only one airport in the U.S. was fully privatized—Stewart in 1999—which has since reverted to public operation.

While there has been extensive use of partial privatization at U.S. airports, there has been little appetite for the long-term lease or sale of U.S. airports primarily due to unique factors as summarized below, only some of which have been addressed in the APPP.

- Control
  - The historic pattern of public ownership of airports
  - Desire of the airport owner (government) to retain control
- Financial Structure
  - The availability of federal planning and development grants and in some cases state grants and loans
  - The ability to impose and require airlines to collect passenger facility charges (PFCs), which provide a capital funding source outside of a contractual airline use and lease agreement or rate schedule imposed by ordinance
  - Ready access to low-cost, tax-exempt financing through the U.S. bond market and in some states infrastructure bank loans with low-cost borrowing
  - The exemption from property taxes for municipal owners
- Regulatory
  - The strict requirements of the grant assurances, accepted as consideration for federal grants
  - The obligation to use proceeds from the sale or lease of airport property only for airport purposes

- The prospect that public entities would be required to repay prior grants upon the sale or lease of an airport to a private operator
- Contractual Constraints
  - The influence of airlines, particularly those that carry the majority of an airport's traffic, as a result of provisions in use and lease agreements providing a significant role in major capital decisions
  - Collective bargaining agreements and public sector unions

## 1.8 Guidebook Organization

The guidebook begins with a discussion of the generic privatization models and the context for applying them in the United States (Chapter 2). It then describes in more detail the specific strategies, legal and regulatory conditions, and the objectives, advantages, disadvantages, and risks associated with each strategy in order from the least to most level of private sector involvement (Chapter 3 through Chapter 7). These chapters provide examples of the various ways U.S. airport owners have used private sector companies in the operation, management, financing, and development of their airports. These examples also illustrate the depth and extensive long-term experience with private operation of airport functions and activities in this country.

Chapter 8 helps the reader understand the process and considerations for identifying and evaluating realistic options for private sector involvement. Chapter 9 provides a summary of the U.S. case studies, which can be found in their entirety in Appendix H.

## CHAPTER 2

# The U.S. Context and Generic Privatization Models

## 2.1 Privatization Continuum and Generic Models

The term “airport privatization” is often understood to mean the transfer of an entire airport to private operation and/or ownership, but privatization does not have to be an all-or-nothing approach. Private sector involvement at airports can take many forms. Privatization refers to the shifting of governmental functions, responsibilities, control, and in some cases ownership, in whole or in part, to the private sector.

Figure 2.1 illustrates the potential range of strategies available for private sector participation in airport management, operation, and development. The range extends from the least level of private involvement to the most private sector involvement. A key distinction is made between:

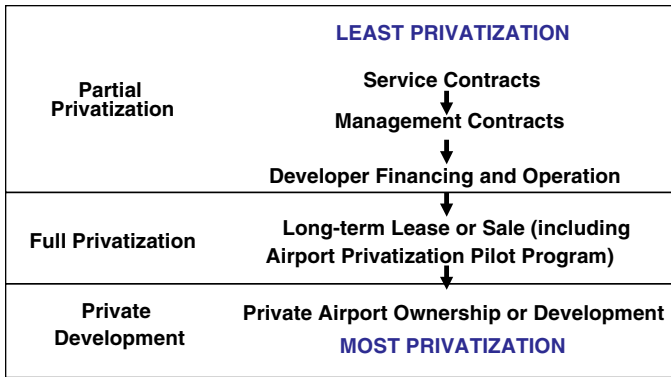
- **Full Privatization**—Full privatization refers to strategies where the full control and/or operation of an entire airport are vested with a private entity, including the long-term lease or sale, whether through the APPP or otherwise. As noted above, APPP is a program under which a long-term lease or sale can occur with full control vested in the private operator except for certain residual powers retained by the airport owner.
- **Partial Privatization**—Partial privatization refers to all other strategies where partial control and full ownership of an airport remains vested with the public owner.

The generic models are summarized below. All but private airport development are considered to be a form of privatization.

- **Service Contracts**—Airport owners routinely contract out to the private sector certain airport services traditionally provided by government or internal employees in order to (1) achieve operating efficiencies through outsourcing

the operation of functions that readily are available through the private sector (e.g., janitorial, escalator/elevator repair, non-police security, parking operations), (2) enhance nonairline revenue (e.g., terminal concessions), or (3) provide project design and delivery (e.g., construction management and program management) for capital improvements.

- **Management Contracts**—Under a management contract, a private entity manages an airport or certain airport facilities for a specified period of time and typically provides little or no capital investment. The private manager’s objective is to improve the financial and operational efficiency of the facility for which the manager is paid a fee and is reimbursed for its expenses, subject to a budget that is usually set by the manager and approved by the airport owner. Most airports operate their public parking facilities using a management contract, and some use a management contract for the operation of individual terminals or master terminal concessions, hangars, warehouses, or, in a few cases, for their entire airport.
- **Developer Financing and Operation**—Developer financing is the most common way to channel private sector investment into public sector infrastructure. Money is borrowed (often through a tax-exempt conduit issuer of municipal bonds) for the specific purpose of financing a project, and lenders are repaid only from the cash flow generated by the project or, in the event the project fails, in some cases, from the value of the project assets. Thus, if project revenues never materialize because the project is abandoned during construction or if project revenues are disrupted because of operational problems, there is no alternative source of cash flow to meet debt service requirements. Most examples of airport project finance transactions in the United States involve special purpose facilities for single or multi-tenant use, typically an airline (e.g., unit passenger terminal, terminal equipment, or fuel storage and distribution systems), one or more cargo tenants (cargo



**Figure 2.1. Examples in the public/private continuum.**

buildings), or rental car companies (consolidated rental car facilities). Sometimes the developer is required to put its own equity capital at risk, but more frequently the project is financed with bonds that are secured solely from the revenues of the facility being financed. This type of transaction is sometimes referred to as a public-private partnership, PPP, or P3.

- **Long-term Lease or Sale**—A long-term lease, long-term concession, sale, or other transfer of an entire airport to private operation and/or ownership (e.g., Stewart).
- **Airport Privatization Pilot Program or APPP**—A program under the category of long-term lease or sale codified at 49 U.S.C. Section 47134, which was enacted by the U.S. Congress in 1996 to allow up to five airports (amended to 10 in 2012) to be leased or sold under specific conditions as approved by the Secretary of Transportation. As described later, the APPP authorizes the Secretary of Transportation to exempt these airports from certain regulations that otherwise may have discouraged airport privatization.
- **Private Airport Development**—Development of an entire airport without the aid of federal or state grants by private investors to be operated as a for-profit business. It should be noted that private airport development without government support is not considered to be airport privatization for purposes of the guidebook since it does not involve the transfer of control or ownership from the public sector to the private sector. For example, Branson Airport which was developed without the aid of federal or state grants is not considered a form of airport privatization.

## 2.2 Extensive Privatization Exists Today at U.S. Airports

There already is a wide range of strategies employed to enlist the support of the private sector in the management and operation of U.S. airports. For example:

- Private companies often perform maintenance on loading bridges, baggage devices, escalators, elevators, moving walkways, etc.
- Private companies (including airlines) provide ground handling of aircraft.
- Cleaning companies frequently provide janitorial services.
- Private parking operators routinely manage public and employee parking lots and associated shuttle bus operations and sometimes finance and develop the parking facilities.
- Food and retail specialists develop and operate terminal concessions.
- Airlines typically design and operate their own passenger processing and baggage handling services.
- Fuel service companies normally operate and maintain fuel systems and fuel aircraft.
- Consultants often perform planning, design, and construction management activities.
- Investment and commercial banks underwrite a large share of the financing for capital improvements.
- Fixed-base operators develop and operate facilities to service general aviation aircraft (including hangars, fueling, terminals, maintenance and avionics services, aircraft sales, charter services, aircraft training and flight support, and ramp) under long-term leases.

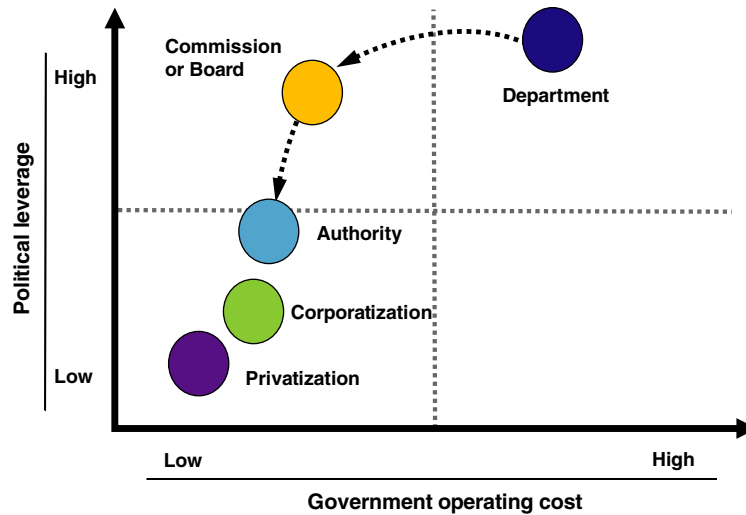
As a result, commercial airports in the United States tend to be run through a form of partnership among the federal government, state government, and local government and the private sector with varying forms of private sector participation.

In fact, a study by the U.S. General Accounting Office (now the Government Accountability Office) in 1996 found that 90% of the people working at the top 69 airports in the United States (in terms of passenger traffic) were employed by private companies. The remaining 10% were employed by local and state governments (performing administrative or public safety duties) or the federal government (e.g., FAA air traffic controllers, military personnel).<sup>2</sup> Private company employees work for airlines, terminal concessionaires, rental car companies, ground parking operators, transportation providers, fixed-base operators, and providers of contract services.

## 2.3 Evolution of Airport Ownership and Governance in the United States

Since the advent of commercial airline service in the 1920s, U.S. airports have largely been owned and operated by local

<sup>2</sup>U.S. Government Accounting Office, *Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports*, Report to the Subcommittee on Aviation, Committee on Transportation and Infrastructure, House of Representatives, GAO/RCED-97-3, November 1996.



Source: LeighFisher.

**Figure 2.2. The airport governance continuum.**

governments. Airlines and aircraft companies participated in the early development of airports (such as Pan American Field in Miami; United Airport, now Bob Hope Airport, in Burbank; and Grand Central Airport in Glendale). However, few private sources of capital stepped forward to invest in owning and operating airports, given the immature nature of the industry (measured by traffic levels, facility use, or revenue generation), the lack of comprehensive federal regulations, and macro-economic conditions of the era (including the Great Depression). In the 1940s, the federal government solidified local public ownership and operation of commercial service airports by (1) enacting the first federal grant program for airports, and (2) transferring excess military bases and related properties no longer needed after World War II to state and local governments under the Surplus Property Act of 1944 under the condition that they be used as public airports.

For decades, the typical owners of commercial service airports have been municipal governments (cities and counties), single-purpose airport authorities, multi-purpose port authorities, and state governments. Single-purpose airport authorities became more common as the industry continued to mature and communities recognized that many airports generated enough revenue to be financially self-sufficient. Airport authorities generally have a more autonomous governance structure that helps insulate management from local politics and gives them relatively more control over salary, procurement, and budgeting systems, resembling the private sector more than local governments. A number of airport authorities were also developed to recognize the regional role of airports in the local community by including representatives from multiple jurisdictions, sometimes sharing the cost to fund airport improvements and giving them more autonomy to respond quickly to changing conditions. Although

public authorities often operate with a degree of independence from state and local government, they typically are influenced by the government through the appointment of board members, the obligation to satisfy at least some of the same requirements as other local agencies, and other factors.

Privatization can be viewed as another form of governance that could be used to address challenges or other structural issues that are facing U.S. airports as illustrated in Figure 2.2. The figure conceptually highlights the general relationship between operating cost and degree of local political control under alternative forms of governance.

## 2.4 Forms of Airport Governance

Airports are often characterized by their ownership, but it is the governance structure that largely determines how an airport is managed, operated, and developed.<sup>3</sup> The consideration of opportunities for increased privatization must begin with an understanding of the ways in which the public and private sectors participate in the governance of commercial service airports currently. As illustrated in Table 2.1, there are four generic models of governance for airports (ranging from least to most private sector control):

- Public ownership and operation
- Public ownership with some form of private operation
- Mixed public/private ownership with private operation
- Private ownership and operation

<sup>3</sup>Daniel S. Reimer, John E. Putnam, James B. McDaniel, *Airport Governance and Ownership*, ACRP Project 11-01, "Legal Aspects of Airport Programs," Transportation Research Board, August 2009.

**Table 2.1. Airport governance models.**

Level of Airport Privatization (from Least to Most)				
<b>Ownership</b>	Public	Public	Public/ Private	Private
<b>Investment</b>	Public	Public/ Private	Private	Private
<b>Management</b>	Public	Private	Private	Private
<b>Types of Private Sector Involvement</b>	<ul style="list-style-type: none"> <li>▪ Retail/service concessions</li> </ul>	<ul style="list-style-type: none"> <li>▪ Management contract</li> <li>▪ Project Finance/ Build-Operate-Transfer (BOT)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Airport-wide concession</li> <li>▪ Airport-wide Build-Operate-Transfer (BOT)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Trade sales</li> <li>▪ Flotation/IPO</li> </ul>

Virtually all commercial service airports in the United States are publicly owned and/or operated either by a state, county, city, single-purpose airport authority, or multi-purpose authority with various forms of private sector participation in their operation and investment. By contrast, international airports tend to have far more private ownership, investment, and operation. Some U.S. airports are owned by a government entity (state, county, or city) but are operated by a single- or multi-purpose authority under a long-term lease.

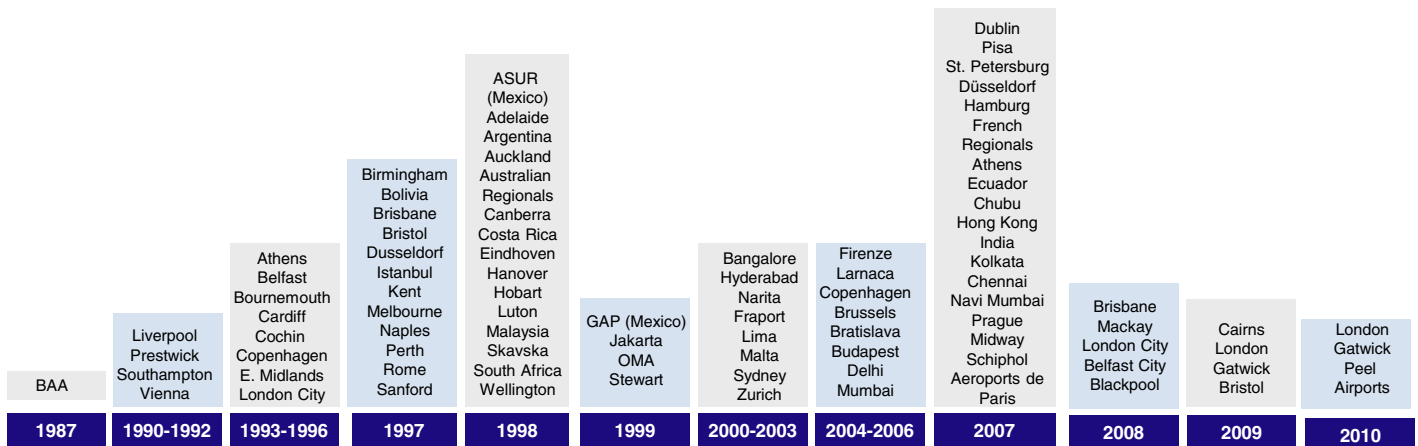
Internationally, many governments have taken steps towards commercialization and/or corporatization as an alternative to, or as interim step towards, airport privatization where this process can generate sufficient revenue for operations and capital funding. Commercialization of airports refers to the application of business-like approaches to the management and operation of airports by shifting aviation management and operations from a government department to a business-focused entity to allow market forces, incentives, and mechanisms to drive the delivery of services. It is a shift in management not ownership of the airport and can include different degrees of private-sector involvement, such as retail development, commercial development, contracting for airport management, or allowing private companies to develop and lease terminals. Commercialization is often the first step

towards full privatization and transferring control of the airport to the private sector, but full privatization does not have to follow.

### 2.5 What Makes the U.S. Airport Model Different?

With the notable exception of the United States, airport ownership and governance have undergone significant change for much of the world since 1987 when the United Kingdom became the first country to privatize some of its major airports as shown in Figure 2.3. Full privatization (i.e., full control and/or operation of an entire airport by a private entity) has become a worldwide trend while partial privatization remains the primary organizational model in the United States. Only one airport in the United States was fully privatized—Stewart in 1999—which has since reverted to public operation.

There has been little appetite for the long-term lease or sale of U.S. airports (full privatization) primarily due to three unique factors: (1) the financial structure for building and improving airports, (2) the U.S. regulatory environment, and (3) the special relationship between airport owners and airline tenants.



**Figure 2.3. 24-year history of worldwide airport privatization.**

### 2.5.1 U.S. Airport Financial Structure

Unlike international airports that often turn to privatization for capital funding, the “three pillars” of airport capital funding in the United States are unique and make full privatization less necessary and desirable:

1. **Airport Improvement Program (AIP)**—The federal government contributes significant federal funding for airport planning and development through the Airport Improvement Program (AIP). The AIP provides grants to public agencies—and, in some cases, to private owners and entities—for the planning and development of public-use airports that are included in the National Plan of Integrated Airport Systems (NPIAS).
2. **Passenger Facility Charges (PFCs)**—PFCs are a source of local capital independent of use and lease agreements and a key instrument to promote competition and capacity. PFCs are an important source of funding for airport infrastructure and a frequent vehicle used to leverage capital. Privatization under the APPP permits the imposition of PFCs. Outside the APPP, a private operator is authorized to impose charges on passengers, subject to reasonableness and non-discrimination requirements of the grant assurances, but is not authorized to impose a PFC, which is separately identified on the passenger ticket.
3. **Tax-Exempt Debt**—The availability of tax-exempt debt provides public airports a cost of capital advantage over private entities. Airport financing under full privatization models would not be eligible for tax-exempt debt. Instruments such as governmental bonds, private activity bonds, and Build America Bonds have been the major financing mechanism for capital improvements at large, medium, and some small hub airports and as a result promote capital investment by state and local governments.

### 2.5.2 U.S. Regulatory Regime

The legal framework for operating public-use airports in the United States is also unique and has significantly influenced the experience and evolution of airport privatization. The U.S. legal structure provides abundant opportunities for airport owners and operators to enlist private participation in certain airport functions and facilities while retaining primary responsibility and control over the airport (partial privatization).

Conditions tied to the acceptance of AIP grants provide a disincentive for full privatization as a result of (1) the constraints imposed by the grant conditions, known as “sponsor assurances” or “grant assurances,” particularly including the requirement to use airport revenue only for airport purposes and (2) the prospect that public entities would be required

to repay prior grants upon the sale or lease of an airport to a private operator.

Both federal law and the grant assurances strictly limit the use of airport revenue for non-airport purposes. Airport revenue is defined broadly to include the proceeds from the sale or lease of airport property. There are some narrow exceptions, such as for so-called “grandfathered” airports and for repayment of loans issued by sponsoring governments. However, Congress has expressed serious concern with revenue diversion and has prescribed onerous penalties for violations. The prohibition on revenue diversion applies only to the airport sponsor, not the air carriers, FBOs, concessions, private airport managers, or any other private entities that conduct business on an airport. This has incentivized private ventures on airports but has dis-incentivized full privatization. It historically presented a particularly high barrier to full privatization because, outside the APPP, the public airport owner is required to use the sale proceeds for airport purposes, and because the private operator, upon assuming responsibility for the grant assurances, must use revenue that it generates in connection with the airport for airport purposes.

Public airport operators enjoy exemptions from property taxation pursuant to the U.S. Constitution and/or laws of most states. These exemptions typically would not apply to a private operator of a public-use airport.

### 2.5.3 Airline-Airport Use and Lease Agreements

Another important distinction is the degree to which airports in other countries tend to be seen more as independent entities and businesses in their own right, with a far lower degree of airline control (contractual or statutory). In the United States, most airport owners enter into use and lease agreements with the airlines serving their airports. Among other things, these agreements set forth the terms and conditions for establishing airline rates and charges and investing in capital improvements. In particular, for airports operating under residual airline agreements—where the airlines guarantee to pick up, through their rates and charges, any airport costs not otherwise covered by non-airline revenues of either a particular cost center or the entire airport—airlines have substantial input into and control of capital investment decisions through “majority-in-interest” approval procedures. In other instances, the airlines have been permitted to form consortia that operate terminals or equipment.

In other parts of the world, airline rates and charges are more likely to be defined by external-economic regulations and less by bilateral contractual agreements, although bilateral agreements can reduce or eliminate the role of the regulator. Those



U.S. airports that do not have airline use and lease agreements must set rates that comply with federal laws and regulations.

Several factors affecting airlines rates and charges in the United States in relation to the privatization models are summarized in Table 2.2.

As a result, airlines generally exert more political influence over U.S. airport owners than they do for international airport owners. Indeed, with their access to public decision makers, some airlines believe they have more leverage with public operators than they could with shareholders and executives of privately owned airports.

In sum, the following features of the U.S. regime have limited the interest in and opportunities for full privatization:

- The historic pattern of public ownership of airports
- Community desires to control their economic engines (airports) and community gateways

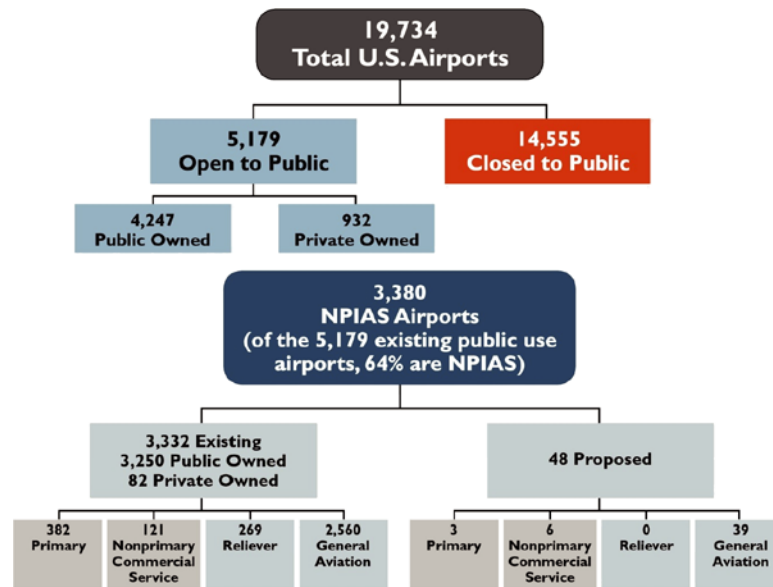
- The availability of federal planning and development grants and in some cases state grants and loans
- The ability to impose and require airlines to collect PFCs, which provide a capital funding source outside of a contractual airline use and lease agreement or rate policy imposed by ordinance
- Ready access to low-cost, tax-exempt financing through the U.S. bond market and in some states infrastructure bank loans with low-cost borrowing
- The strict requirements of the grant assurances, accepted as consideration for federal grants
- The obligation to use proceeds from the sale or lease of airport property only for airport purposes
- The prospect that public entities would be required to repay prior grants upon the sale or lease of an airport to a private operator
- The exemption from property taxes for municipal owners

**Table 2.2. Summary of U.S. economic rules under partial and full privatization.**

Factor	Partial Privatization	Full Privatization Under APPP	Full Privatization Outside APPP (per FAA Order 5190.6B)
Eligibility for AIP grants	Public entity is eligible	Private entity may be eligible, but with lower discretionary federal share (70%)	Private entity is not eligible
Eligibility for tax-exempt debt	Same terms as government	No*	No*
Property tax exemption	Not applicable	Not unless special legislation	Not unless special legislation
Ability to impose a PFC	Public entity is eligible	Public entity is eligible	Private operator can impose a charge on passengers, but not require the airlines to collect a PFC
Prohibition on revenue diversion	<ul style="list-style-type: none"> <li>▪ Government must comply</li> <li>▪ Operator exempt</li> </ul>	<ul style="list-style-type: none"> <li>▪ Government must comply unless 65% airline approval at primary airports</li> <li>▪ FAA is authorized to grant an exemption to permit the private operator to “earn compensation from the operations of the airport”</li> </ul>	<ul style="list-style-type: none"> <li>▪ Government must comply</li> <li>▪ Operator permitted to be paid reasonable compensation for providing airport management services and reasonable return on capital investment**</li> </ul>
Reasonable terms, no unjust discrimination (subject to rates & charges policy)	Government and operator must comply	Operator cannot increase aeronautical rates by more than inflation without airline approval	Operator must comply

\* To qualify for federal tax exemption, the assets being financed must satisfy the government ownership requirement that the lease term does not exceed 80% of the economic life of the asset. Also, to use tax-exempt debt to acquire an existing asset, at least 15% of the debt must be used to pay for a new asset and the proceeds must be spent within three years of the issuance.

\*\* As stated in the FAA’s revenue use policy, “The FAA expects private owners to be subject to the same requirements governing . . . the recovery of unreimbursed capital contributions and operating expenses from airport revenue as public sponsors. Under section 47107(l)(5), private sponsors—like public sponsors—may recover their original investment within the six-year statute of limitation. In addition, they are entitled to claim interest from the date the FAA determines that the sponsor is entitled to reimbursement under section 47107(p). Any other profits generated by a privately owned airport subject to section 47133 (after compensating the owner for reasonable costs of providing management services) must be applied to the capital and operating costs of the airport.” 64 Fed. Reg. 7696, 7700 (1999).



Source: Federal Aviation Administration, *National Plan of Integrated Airport Systems (2009-2013) Report of the Secretary of Transportation to the United States Congress*, September 27, 2010.

**Figure 2.4. Number of existing and proposed airports by ownership and use.**

- Other regulatory factors outlined in more detail in Chapter 6
- The influence of airlines, particularly those that carry the majority of an airport's traffic, as a result of provisions in use and lease agreements providing a significant role in major capital decisions

A combination of access to AIP grants, PFCs, and tax-exempt debt make partial privatization strategies more attractive to U.S. airport owners. Conversely, limitations in AIP participation, inability to charge PFCs, and limited or no access to tax-exempt debt under full privatization schemes limit the ability of the private operator to attract capital relative to a public owner.

## 2.6 Focus of Research

The guidebook is focused on the relatively small number of airports that contribute disproportionately to air transportation and mobility in the United States and to economic output and impact. Virtually all of these airports are owned by government agencies.

In the United States, there are 19,734 airports; however, 14,555 of these (74% of the total) are privately owned, privately-used facilities as shown in Figure 2.4. An additional 932 airports are privately owned publicly-used facilities.

Only 4,247 airports (21% of the total) are publicly owned, publicly-used facilities. Yet these airports account for virtually all scheduled commercial passenger boardings in

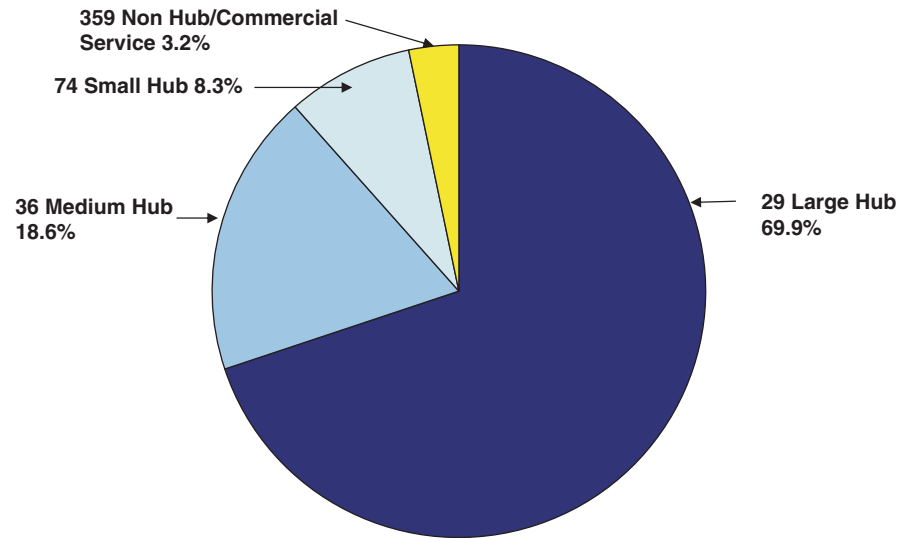
this country, as there is only one privately developed, commercial service airport currently operating (in Branson, Missouri). Similarly, these airports account for the vast majority of general aviation and cargo activity, as virtually all of the busiest general aviation and cargo airports are publicly owned.

Federal law and policy both reflect and support this fact. Almost all of the airports in the NPIAS are publicly owned. This includes commercial service airports, reliever airports, and select general aviation airports. Indeed, a commercial service airport, for which the majority of federal funding is reserved, is defined in federal law to include *only* airports owned by public agencies.<sup>4</sup> The consequence of these and related laws and policies is that federal financial assistance largely has been limited to publicly owned airports.

Further, passenger activity in the United States is highly concentrated in a relatively small number of the commercial service airports. As shown in Figure 2.5, the top 65 airports (representing the large and medium hubs) accounted for nearly 89% of enplaned passengers in the United States during 2010.

The guidebook focuses on the role of the private sector in publicly owned, publicly-used airports, with particular attention to large commercial service airports that account for the vast majority of scheduled passenger traffic and cargo.

<sup>4</sup>See 49 U.S.C. § 47102.



Source: Federal Aviation Administration, *CY 2010 Revenue Passenger Enplanements for primary and nonprimary commercial service airports (by rank)*, October 2011.

**Figure 2.5. Passenger shares at U.S. commercial airports.**

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## CHAPTER 3

# Service Contracts

### 3.1 Specific Strategies

Contracting of services or outsourcing refers to the delegation of operations from the public sector to a private entity that specializes in the operation, maintenance, or management of that activity. Most U.S. airport owners outsource at least some services or functions.

Findings from a 2004 airport survey indicate:

- Concession management and custodial services are the most common services outsourced.
- Outsourcing is more common in large airports, although smaller airports tend to outsource more specialized services such as legal and accounting.
- Airport directors use outsourcing primarily to achieve predictable reductions in the costs of non-core activities and to obtain on-demand specialists and lower level support personnel at lower costs.<sup>5</sup>

Examples include:

#### *Traditional*

- Maintenance services (e.g., terminal cleaning and janitorial, window cleaning, landscaping)
- Conveyance systems (e.g., elevators, escalators, moving walkways)
- Mechanical systems (e.g., HVAC)
- Airline equipment (e.g., baggage systems, jetways, pre-conditioned air, common use equipment)
- People mover systems
- Parking operations
- Shuttle bus operations
- Financial planning
- Financial advisory

<sup>5</sup>J. Gonzalez, *Outsourcing and Airport Services*, Airport Magazine, Volume: 16, American Association of Airport Executives, May/June, 2004.

#### *Less Typical*

- Development agents for commercial land development
- ARFF
- Security guards
- Law enforcement
- Terminal concession development and management

#### *Project Development and Delivery Services*

Many airports have adopted frameworks for construction and/or program management to allow the airport owner to economically and efficiently administer airport development projects. Construction management services tend to be used for single projects while program management services are employed to deal with a multitude of integrated, concurrent construction projects whereby the program manager provides the technical expertise to oversee all the projects within a large capital program on the airport owner's behalf. Examples include:

- Planning studies (e.g., master plans)
- Architectural, engineering, design
- Construction inspection
- Construction management (e.g., procurement assistance, contractor oversight, inspection and testing, project close out, external coordination)
- Program management (e.g., scheduling, design oversight, project controls, accounting/finance, construction bid evaluation, construction manager oversight, comprehensive status and progress reports, administrative support)

In general, airport owners pursue these strategies to realize cost savings and to enlist specialized expertise from the private sector.

### 3.2 Examples of Service Contracts

There has been a wide variety of service contracting employed in the United States as illustrated by the following examples.

### 3.2.1 Maintenance Contracts

Subcontracting with private companies for all types of services is routine for U.S. airports, including maintenance services (e.g., terminal cleaning, window cleaning), conveyance systems (e.g., elevators, escalators, moving walkways), mechanical systems (e.g., HVAC), people mover systems, shuttle bus operations, airline equipment (e.g., baggage systems, jetways, pre-conditioned air, common use equipment). For example, the City of Manchester, New Hampshire, which owns and operates Manchester Airport, outsources a significant number of services through contractual arrangements, including terminal cleaning and mechanical systems. The city also contracts out HVAC, elevator, escalator, and jetway maintenance services.<sup>6</sup> The city has used this approach for many years so it appears to be working well for them.

### 3.2.2 ARFF and Law Enforcement Service Contracts

Less typical is the contracting of services for ARFF and law enforcement. The City of Manchester also outsources its law enforcement and ARFF functions. The Rockingham County Sheriff's Department provides law enforcement, security services, and central communication services under a publicly bid, fixed-price contract. Centurion Protection, Inc. provides ARFF services under a fixed price contract whereby the airport provides all of the equipment and facilities and Centurion provides the services to comply with FAA standards and requirements.<sup>7</sup>

### 3.2.3 Fuel System Operation

A number of U.S. airport operators own the airport jet fuel storage and distribution system and contract out the maintenance, operation, and management to qualified and experienced airport fuel system operators (e.g., Oakland, Guam).

### 3.2.4 Contract to Operate Common Use Equipment

Airline consortia operate and manage common use equipment and systems at several airports, including Chicago O'Hare's Terminal 5, the Tom Bradley International Terminal at Los Angeles International Airport, and the International Terminal at San Francisco International Airport.

At San Francisco, the airlines operating in the International Terminal Complex (ITC) formed the San Francisco Terminal

Equipment Company, LLC (SFOTEC) to use, operate, and maintain certain airport-owned common use equipment and systems related to handling flights and passengers.<sup>8</sup> The equipment includes computer check-in systems with baggage and boarding pass printers, flight information systems, baggage handling systems, passenger loading bridges, and systems for delivering pre-conditioned air to aircraft and ground power for aircraft. The airport financed the cost of the equipment with airport bond proceeds while SFOTEC manages the daily assignment of the ITC joint use gates, holdrooms, ticket counters, and baggage systems to the airlines operating in the ITC in accordance with airport approved protocols.

Under the services contract between the airport and SFOTEC, SFOTEC is obligated to (1) maintain, operate, repair, and schedule the common use of such equipment, (2) pay the associated utility and custodial costs, and (3) provide non-discriminatory access to such equipment for all ITC carriers, whether or not they are members of SFOTEC. The costs of operating and maintaining the equipment are shared by all airline users of the equipment. The user fees for airlines that are members of SFOTEC are determined under the terms of the SFOTEC Members Agreement, while the user fees of non-member airlines are negotiated between SFOTEC and the non-member airlines (charter airlines).

## 3.3 Legal and Regulatory Considerations

Although service contracts are common at U.S. airports, the FAA has not promulgated specific rules or published detailed policies or guidance on them. Service contracts must however follow standard local, state, and federal procurement rules. In some cases, such as contracting for ARFF services, other federal regulations (i.e., FAR Part 139) must be followed. When considering contracts for law enforcement services, federal law (i.e., TSR Part 1542) may be relevant and state laws often define the parties that are permitted to provide such services.

## 3.4 Evaluation of Service Contracts

### 3.4.1 Opportunities

The main opportunities provided by service contracts include:

- May reduce operating expenses due to lower private sector employment and overhead costs, and thereby reduce costs to tenants

<sup>6</sup>City of Manchester, New Hampshire, *Official Statement, General Airport Revenue Bonds*, June 23, 2005.

<sup>7</sup>Ibid.

<sup>8</sup>City and County of San Francisco, *Official Statement, San Francisco International Airport Second Series Revenue Bonds, Series 2009E*, November 5, 2009.

- Accesses private sector expertise for specialized functions
- Applies private sector techniques to accelerate project delivery and reduce construction costs for capital improvements
- If applicable, uses private agents for commercial development

### 3.4.2 Advantages

The main advantages provided by service contracts include:

- Provides potential to cut costs and optimize efficiency
- Retains airport oversight of contracts to ensure compliance with airport goals
- Reduces airport costs for employee salaries and benefits as well as post retirement expenses and liability (pension, medical, etc.)
- Involves low implementation risk and complexity
- Allows airport management to focus on core and strategic issues
- Maintains airport owner control over land uses and facilities

Airlines view contracting of services as a viable option towards a broader goal, such as lower costs or more efficiency at an airport. Because airport costs play an increasing role in airline service decisions, there is added impetus for airport owners to consider outsourcing services. Airlines have also embraced the concept of the airline terminal equipment maintenance consortium as a means of achieving cost savings.

Some international airport operators believe their cost structure is lower than U.S. airports because most of their services are contracted out.

### 3.4.3 Disadvantages and Risks

The main disadvantages and risks under service contracts involve relations with public employees:

- Could involve organizational disruption (i.e., reassignment or termination of existing employees)
- Could encounter labor resistance in an effort to protect and increase public sector jobs
- Requires careful monitoring, which can be expensive and time-consuming
- Presents tension in the outsourcing relationship—the contractor wants to make a profit and the airport owner wants to cut costs

Organized labor in the United States wants to be involved in all parts of the airport industry from design, construction, and maintenance of infrastructure to its operation with unionized employees. Privatization is an issue unions track closely to ensure the interests of their members (both public and private sector) are protected. This includes concern that abrogating union contracts, limiting the collective bargaining rights of labor, and cutting wages and benefits might become attractive cost-saving strategies for potential private owners of airports. Any privatization policies that enable either the direct abrogation of union contracts, the contracting out of existing airport employees' work, or have the clear effect of reducing wages and benefits will be measures labor strongly opposes. In some cases, this reality may dissuade airport owners from privatizing work.

Outsourcing can save money if airport owners are careful about what they buy and if they set up performance-based contracts that hold contractors accountable for meeting quality service standards. Outsourcing a service that invites risk, and failing to manage that risk through active contract monitoring, can produce unfavorable results.

While some U.S. airport managers cited several examples of successful service contracts (e.g., airline equipment consortia), others were more critical of them. In fact, several airport managers pointed to examples of certain functions that had been privatized, but reverted to public control or ownership, including janitorial services, baggage handling systems, jetway maintenance, and ramp control services. See Chapter 7 for further discussion.

In March 2011, New York City's deputy mayor, Stephen Goldsmith, who had been known as "the prince of privatization" when he was mayor of Indianapolis in the 1990s, announced plans to "in-source" services that the city had previously privatized to save money. He claimed to find \$41 million in immediate savings by taking the work of the city's data center and wireless network back in-house.<sup>9</sup>

In sum, tasks that are well-defined, easy to monitor, and available from competing contractors—sometimes called commodity tasks—are prime candidates for outsourcing. Conversely, tasks that are complex, changeable, lack clear benchmarks, or have little or no competition—custom tasks—are often kept in-house.<sup>10</sup>

<sup>9</sup>*Is Privatization a Bad Deal for Cities and States?* New York Times (Opinion Pages), April 3, 2011.

<sup>10</sup>John Donahue, *Outsourcing the Wrong Jobs*, New York Times, April 4, 2011.

## CHAPTER 4

# Management Contracts

### 4.1 Specific Strategies

Numerous airports have contracted out the management and operation of parking facilities, concession operations, or entire terminals where the operator manages the facility on behalf of the airport owner for a specified period of time and in return receives a management fee.

A number of airport owners in the United States have contracted the day-to-day operation of their entire airport to private operators. Under an airport-wide management contract, an operator manages the airport (or airport system) under policies and direction from the airport owner for a specified period of time. The operator's objective is to improve the financial and operational efficiency of the airport, and the operator is typically paid an annual fixed management fee. Sometimes the operator is paid a variable fee based on performance.<sup>11</sup>

The airport owner retains a considerable degree of control over the quality of service provided by the contractor by setting policy and also retains the obligation, control over, and risks for making capital investments. (The contractor does not bear any of the risks for capital improvements.) The operating budget is usually set and managed by the operator, but approved by the airport owner. Frequently, these types of arrangements are introduced when the airport owner feels the transition can introduce a more efficient operation of the airport where the objective of the operator would be to reduce costs and increase revenues. Another reason might be to improve customer service. This type of arrangement has also been used when an airport transitions from a municipal or state-run operation to an independent airport authority (e.g., Albany, Harrisburg).

Sometimes the airport owner contracts separately for (1) general airport management, operation, and maintenance, (2) ARFF services, and (3) parking services.

Even in cases where the airport owner contracts out most of the day-to-day operation of its airport, it may retain control

over certain functions. For example, the Burbank-Glendale Pasadena Airport Authority maintains its own police department. Sometimes the airport owner retains the responsibility for supervising and providing airport police services (e.g., Harrisburg International Airport).

Functions that the airport owner typically retains under its control include:

- Airline use agreement compliance
- Rates and charges policy
- Air service development policy
- Assurances and compliance for federal and state grant programs
- Long-range planning
- Capital expenditure policy and implementation
- Debt issuance policy
- Land acquisition and development policy and planning
- Airport industrial and economic development policy (and sometimes management)
- Environmental policy

Often the management fee is fixed with little or no incentive component, which effectively means the arrangement is one large service contract. By comparison, in Indianapolis the initial fee structure was based almost entirely on incentive compensation where the airport authority's main objective in contracting with BAA was to reduce airline payments per enplaned passenger. The community felt that this would induce the airlines to provide more air service, which in turn was expected to stimulate regional economic development.

### 4.2 Examples of Management Contracts

There has been a wide variety of management contracting employed in the United States as illustrated by the following examples.

<sup>11</sup>See for example the Indianapolis case study where BAA was paid on the basis of savings generated.

### 4.2.1 Terminal Management Contracts

Some airports have contracted out the management and operation of entire terminals.

**Atlanta Hartsfield International Airport.** At Atlanta Hartsfield International Airport, the central passenger terminal complex (CPTC) is operated and maintained on behalf of the airlines by the Atlanta Airlines Terminal Corporation (AATC), a corporation established by the airlines for that purpose. The City of Atlanta (the airport owner and operator) has also contracted management, operation, and maintenance of the international terminal facilities to TBI Airport Management, Inc. The city recovers from TBI its allocable operating and maintenance expenses according to the guidelines of the CPTC leases. TBI pays all other operating and maintenance expenses and, in turn, recovers all the costs and expenses, plus a management fee, from the airlines through quarterly use charges.

**Orlando Sanford International Airport.** The Sanford Airport Authority contracts with TBI Airport Management, Inc. to manage the international and domestic terminals, develop additional air service, and provide ground handling and cargo services at Orlando Sanford International Airport. The airport authority manages and operates the rest of the airport with a staff of 50, which provide ARFF, police, administration, and other services.

### 4.2.2 Parking Management Contract or Concession Agreement

Although some airports continue to operate their parking facilities using airport employees (e.g., Dallas/Fort Worth, Norfolk, and Seattle), most U.S. airports retain private companies to operate their parking facilities and shuttle buses using either concession agreements or management contracts. Management contracts are the more frequently used model. Under the terms of a concession agreement, the private operator is typically responsible for all aspects of day-to-day parking operations, including facility maintenance and fee collections. As payment for their services, the concessionaires receive a percentage of the gross revenues from parking operations but are required to pay the airport owner the greater of this percentage amount or a minimum annual guaranteed amount. In this manner, the concessionaire assumes most of the risk for potential downturns in parking revenues, but also receives greater rewards if there is an unexpected increase in airline passenger traffic. Examples include the airports serving Baltimore/Washington, Dayton, Cleveland, Erie, Honolulu, and Houston (Intercontinental).

With a parking management contract, the airport provides the parking facilities (including the revenue control equipment and buses), establishes minimum customer service standards,

reserves the rights to adjust parking rates, and then retains a private operator to manage the operation under a budget that is approved by the airport. The private operator is reimbursed for their authorized expenses and is also paid a management fee. With a management contract, the airport operator assumes most of the risk for a downturn in parking revenues, receives most of the reward for increased parking business, and, compared to a concession contract, has greater latitude to control and modify customer service standards. Examples include airports serving Burbank, Orange County (California), Nashville, Orlando, Pittsburgh, San Francisco, and Tulsa.

Some airports use combinations of concession contracts and management agreements. For example, they may use concession contracts for economy parking and management agreements for valet parking or shuttle bus operations.

### 4.2.3 Master Terminal Concessionaire or Developer Agreement

Airport owners have entered into master concessionaire agreements for their terminal food, beverage, and retail operations at numerous airports.

BAA USA was retained as the master developer and manager of the retail, food, and beverage operations at the AIRMALL® at Pittsburgh International Airport in 1992.<sup>12</sup> When the Midfield Terminal opened in 1992, Pittsburgh became the first airport in the United States to offer a shopping mall-type approach for retail activities for its passengers. According to the Allegheny County Airport Authority, as of June 1, 2010, there were 40 operators in 70 locations in the Midfield Terminal, including 23 food and beverage locations, 34 retail locations, four service locations and nine news and gift locations. AIRMALL® USA manages the food, beverage, and retail activities in the Midfield Terminal under a Master Lease Development and Concession Agreement with the airport authority. AIRMALL® USA acts as the authority's master lessee and is responsible for developing concession and retail activities at the Midfield Terminal for the authority. AIRMALL® USA has the exclusive rights to manage all terminal concessions (except public pay telephones), including retail, food and beverage, and advertising services. The authority receives 100% of revenues from electronic media, such as the Internet, flight information systems, and the wireless airport system. AIRMALL® USA is not authorized to operate terminal concessions except in the case of a vacancy. The authority receives 59% of the revenues received by AIRMALL® USA from the various concessionaires, and AIRMALL® USA receives 41%.

<sup>12</sup>BAA USA was acquired by the Prospect Capital Corporation, an investment company based in New York City, from its previous owners, BAA Ltd., in a transaction that was completed on July 30, 2010. As part of the transaction, BAA USA is now known as AIRMALL® USA, Inc.



**Table 4.1. Examples of airport-wide management contracts.**

<b>Airport</b>	<b>Owner</b>	<b>Operator</b>
<b>Commercial Service Airports</b>		
Albany International Airport (ALB)	Albany County Airport Authority	AvPorts and Go-Albany, Inc.
Atlantic City International Airport (ACY)	South Jersey Transportation Authority	AvPorts
Bob Hope Airport (BUR)	Burbank-Glendale-Pasadena Airport Authority	TBI Airport Management, Inc.
Lehigh Valley Airport (ABE)	Lehigh-Northampton Airport Authority	AvPorts
Rochester Airport, Minnesota (RST)	City of Rochester, MN	Rochester Airport Company
Stewart International Airport (SWF), Newburgh, New York	Port Authority of New York and New Jersey	AvPorts
Westchester County Airport (HPN), White Plains, New York	Westchester County, NY	AvPorts
<b>General Aviation Airports</b>		
Addison Airport, TX	Town of Addison, TX	Washington Infrastructure Services, Inc. and Staubach Airport Management, Inc.
Brackett Field Airport	Los Angeles County, CA	American Airports
Compton/Woodley Airport	Los Angeles County, CA	American Airports
El Monte Airport	Los Angeles County, CA	American Airports
Republic Airport (FRG), Farmingdale, New York	New York Department of Transportation	AvPorts
Rhode Island – Providence (PVD) and 5 GA airports (PVD, UUU, WST, BID, SFZ, OQU)	Airports owned by State of RI, but RI Airport Corp (a subsidiary public corp. of the RI Economic Dev. Corp.) is airport sponsor	RIAC operates TF Green, but leases out operation and day-to-day management of 5 GA airports to Landmark Aviation (formerly Hawthorne Aviation)
Teterboro Airport (TEB), New Jersey	Port Authority of New York and New Jersey	AvPorts
Tweed New Haven Regional Airport, New Haven, Connecticut	City of New Haven, CT	AvPorts
Whiteman Airport	Los Angeles County, CA	American Airports
William J Fox Airfield	Los Angeles County, CA	American Airports

AIRMALL® USA also contributes to a repair and replacement fund to cover certain repair and replacement costs.<sup>13</sup>

Westfield Concession Management (Westfield) manages the food and beverage programs at Reagan National and Dulles International on behalf of the Metropolitan Washington Airports Authority. Under these agreements, Westfield develops and manages the food and beverage programs at the airports, but does not operate any of the concession facilities. Westfield negotiates contracts with each concessionaire using a standard lease that has been approved by the Airports Authority. These contracts generally obligate the concessionaire to pay the higher of a minimum annual guarantee or a percentage of gross revenues. Westfield collects all rents and fees from the concessionaires and retains a portion of gross rental payments as its fee for the management services.

Other examples of master developers and managers of retail, food, and beverage operations include:

- AIRMALL® USA at Boston Logan International Airport (Terminals B and E) in July 2000

- AIRMALL® USA at Baltimore/Washington International Thurgood Marshall Airport in March 2004
- AIRMALL® USA at Cleveland Hopkins International Airport in February 2008
- Marketplace Development at Philadelphia International Airport
- Marketplace Development at LaGuardia Airport

#### **4.2.4 Airport-wide Management Contracts**

As shown in Table 4.1, a number of airport owners in the United States have contracted for the operation of their entire airports by private operators. These types of agreements are more commonly found at general aviation airports.

A description of some of these arrangements and others follows.

**Bob Hope Airport.** Bob Hope Airport is owned by the Burbank-Glendale-Pasadena Airport Authority, which contracts with TBI Airport Management, Inc. for general airport management, operation, and maintenance; Pro-tech Fire Services, Limited for ARFF services; a joint venture of Central Parking Systems and Valet Parking Services for parking

<sup>13</sup>Allegheny County Airport Authority, *Official Statement, Airport Revenue Refunding Bonds, Series 2010A*, August 3, 2010.

services; and Wyle Laboratories for services in connection with noise abatement. The airport maintains its own police department (Burbank-Glendale-Pasadena Airport Authority Police) that is separate from the Burbank Police Department. This airport has been under private operation its entire existence having been developed in 1928 by Boeing Aircraft and Transport (BA&T), which was a holding company that included Boeing Aircraft and United Air Lines. The airport was initially named United Airport. Lockheed Air Terminal, Inc. owned and operated the airport from 1940 until it was sold to the Authority in 1978.

**Albany International Airport.** The Albany County Airport Authority was created by the State of New York in 1993 with a 40-year lease to operate the airport. The Authority has contracted with AvPorts, Inc., a subsidiary of AFCO, to manage the daily operations of the airport and with Go-Albany, Inc., d/b/a Million Air—Albany, a subsidiary of Million Air Interlink, to manage the daily operations of the airport's fixed-based operations.

AvPorts has the daily responsibility, under policies and direction from the authority, for airport operations, airside security, ARFF, terminal and vehicle maintenance, and the parking facilities. TBI Airport Management, Inc. operated the airport on behalf of the Authority from 1993 through September 2005.

Go-Albany has the daily responsibility, under policies and direction from the authority, for the fixed-based operations, including commercial into plane fueling, fuel farm management, and general aviation handling and fueling. In 2005, the authority purchased the fixed assets and fuel inventory located on the airport from Aircraft Services International Group (ASIG) with the goal to enhance fueling services for the general and corporate aviation community by offering competitive rates and charges for users of the airport and to provide the airlines at the airport with efficient and quality plane fueling services and fuel inventory management. Go-Albany is reimbursed for its actual expenditures based on an employment level approved by the Authority plus a fixed fee with added incentives based on the growth of fixed-based operation revenues.

All expenditures incurred by AvPorts and Go-Albany are subject to the approval of the authority.

**Indianapolis International Airport.** In 1994, the Indianapolis Airport Authority solicited bids to manage its airport system that included Indianapolis International Airport and five general aviation airports. The winning bidder, BAA Indianapolis LLC, won a 10-year management contract extending from October 1, 1995 through September 30, 2005. The contract was extended to the end of 2008 but was later terminated (effective July 16, 2007) under mutual agreement by

both parties to provide for (1) an early transition of personnel and operations back to the Authority and (2) a smooth transition in advance of the opening of the new \$1.07 billion Midfield Terminal in late 2008. There was no significant change in the operation and management of the airport facilities in connection with the transition. BAA was paid a performance fee, monthly fixed fee, and transition incentive fee under the terms of the June 14, 2007 amendment.

The airlines felt that while there were benefits at the front end of the contract, toward the end of the lease the airport and airlines were questioning the value of the payments to BAA relative to the benefits derived.

**Harrisburg International Airport.** In January 1998, the Commonwealth of Pennsylvania transferred the ownership and operation of Harrisburg International and Capital City Airports to the Susquehanna Area Regional Airport Authority (SARAA), which is a joint municipal authority created to own, develop, and operate the two airports. Simultaneously, SARAA entered into a 10-year management agreement with BAA Harrisburg, Inc. (BAAH) for the operation and maintenance of the airport system. The scope of BAAH's services included the operation, maintenance, and development of the terminal, airfield, landside, water, and sewer facilities of the airport system, as well as administrative management. SARAA retained responsibility for supervising and providing airport police services and for managing the industrial park at Harrisburg International Airport. SARAA attempted to renegotiate the terms of BAAH's management contract in November 2000 due to concerns about declines in passenger traffic and BAAH's administration of the airport system. The authority was unsuccessful in renegotiating the terms of the contract to allow it to have more day-to-day responsibilities in the management of the system. Therefore, SARAA terminated the contract in July 2001. The airport system is now managed and operated by SARAA.<sup>14</sup>

**Los Angeles County Airports.** American Airports manages and operates the five general aviation airports owned by Los Angeles County. In 1991, Comarco was awarded a 20-year management contract (with two 5-year renewal options at the county's option) to effectively operate as airport management: collecting rents, conducting day-to-day operations, and running the airport's capital program. Comarco subsequently sold the contract to American Airports in 2000. American Airports also acts as leasing manager for the airports, negotiating and setting rates with tenants. When Comarco was awarded the management contract for the airports, the system

<sup>14</sup>Official Statement, *Susquehanna Area Regional Airport Authority, Airport System Revenue Bonds, Series 2004*, July 30, 2004.

generated a \$1 million annual loss, but subsequently turned the enterprise around to generate a \$2 million annual profit. As leases expired, American Airports was able to re-set to market rates and escalated them at the CPI. Los Angeles County retains staff for contract administration (the county still reviews and approves leases of more than one month's duration), capital planning, grants administration, master planning, strategic planning, construction, and inspection, but reduced airport staff from 90 to 9. In addition, American Airports assumed all liability as airport operator and is responsible for carrying out airport maintenance to a set standard. Based on the revenue share approach, American Airports bears the risk of managing airport costs. The first 5-year option was exercised in 2011, extending the contract through April 2016.

#### 4.2.5 Expressions of Interest for Ontario International Airport

In January 2011, Los Angeles World Airports (LAWA) released a request for expressions of interest from the private sector and other interested parties to possibly contract out the operation of LA/Ontario International Airport. The airport is owned by LAWA, which also owns Los Angeles International Airport and Van Nuys Airport, a general aviation facility. The expressions of interest packets ask parties how they might be able to (1) return the airport to pre-2008 passenger traffic trends and increase its share of air traffic in the Los Angeles region, (2) effectively market the airport to airlines, passengers, and air cargo companies, (3) operate the airport more efficiently, and (4) balance the short-term improvement initiatives currently underway at the airport while maintaining its long-term capacity for growth. LAWA received 10 responses to the expressions of interest, including private operators of local and national GA airports, international airport operators, and infrastructure investors.

LAWA operates Ontario International Airport under a long-term joint powers agreement with the city of Ontario. Officials from the city of Ontario have been in negotiations with the city of Los Angeles and LAWA to return control to Ontario. City officials in Ontario believe local control would better address the steep decline in passenger traffic experienced at the airport since 2007 and mitigate LAWA's high costs of operating the airport, which contribute to relatively high airline charges. (The main factor in increasing airline charges was the 30% decline in passengers between 2007 and 2009). As of December 2011, no action has been taken on the expressions of interest and there has been no movement on the city of Ontario's request to take back control of the airport.

### 4.3 Legal and Regulatory Considerations

The FAA has provided guidance on management contracts. Grant Assurance 5(f) provides as follows:

If an arrangement is made for management and operation of the airport by any agency or person other than the sponsor or an employee of the sponsor, the sponsor will reserve sufficient rights and authority to ensure that the airport will be operated and maintained in accordance with Title 49, United States Code, the regulations and the terms, conditions and assurances in the grant agreement and shall ensure that such arrangement also requires compliance therewith.

The FAA's *Airport Compliance Manual* contains the following additional details on management contracts.<sup>15</sup>

1. A public airport owner may contract with an agent to perform airport management or other administrative and supervisory functions. This arrangement may be defined in a management contract, lease or both.
2. The public airport owner remains the airport sponsor, and therefore is responsible for compliance with all grant assurances and other federal obligations. (Note that the difference between full and partial privatization in the instance of a lease of an entire airport is whether the public airport owner continues to be the airport sponsor.)
3. The public airport owner can permit the private airport manager to conduct aeronautical activities, such as serving as a FBO, in addition to providing management functions. The airport owner will have different obligations and requirements, pursuant to the grant assurances, in its treatment of the private entity acting as an FBO than acting as the airport manager. FAA encourages public airport owners to execute separate agreements for airport management functions and aeronautical activities to reflect these different requirements.
4. Consistent with Grant Assurance 5(f), the FAA recommends that a management agreement include particular terms requiring that the private entity conduct its activities consistent with the grant assurances and other federal obligations imposed on the public airport operator and that the management agreement itself be subordinate to the grant assurances.

Management contracts must also follow standard local, state, and federal procurement rules.

Another consideration is the impact of the management contract on the tax status of outstanding debt.

- Under management contracts of facilities financed with tax-exempt bonds, it must be determined if the contract

<sup>15</sup>FAA Order 5190.6B, § 6.13 (Airport Management Agreements).

meets the “qualified management contract” test under Internal Revenue Service (IRS) regulations. Failure to meet the requirements of a qualified management contract could result in a judgment that a “private business use” is being made of the facilities financed with tax-exempt bonds.

- At the same time, the term of the management contract needs to be long enough for a private company to realize savings from operational efficiencies. IRS regulations governing qualified management contracts establish compensation requirements and limit the term to 10 or 15 years depending on the nature of the compensation arrangement. Only certain “public utility properties” (i.e., electric energy, water, or sewage disposal services) can qualify for a term as long as 20 years. As a result, management contracts of entire airports tend to be no longer than 10 years.

## 4.4 Evaluation of Management Contracts

### 4.4.1 Opportunities

The main opportunities provided by management contracts include:

- May reduce operating expenses due to lower private sector employment and overhead costs, and thereby reduces costs to tenants
- May or may not release contractor from local procurement regulations
- Can streamline and improve certain processes, especially with regard to renegotiating nonairline contracts
- Accesses private sector expertise for specialized functions and commercial development
- Provides potential for new revenue/economic development initiatives on airport
- Furnishes potential to impose contractual obligation for contractor to achieve performance targets
- Provides opportunity for staff to gain management expertise

For example, in Indianapolis, BAA’s operation was beneficial for staff as a whole because employees gained broader airport management expertise and had the opportunity to interact with colleagues in the United Kingdom. This interaction was valuable, as it brought to staff the private sector airport management perspective.

Typically, under an airport-wide management contract, the airport owner’s objective is to improve the financial and operational efficiency of the airport. The operator’s objective is to fulfill the desires of the airport owner as expressed in the management contract in order to get paid a fee. The operating budget is usually set and managed by the operator

and approved by the airport owner. Frequently, these types of arrangements are introduced when the airport is unprofitable, and the objective of the operator would be to reduce costs and increase revenues.

As an example of cost savings, in December 2010 the Kent County Aeronautics Board, which oversees Gerald R. Ford International Airport in Grand Rapids, Michigan, decided to enter into a management contract for its parking operations at the airport to save the airport between \$1.5 million and \$1.9 million over five years.<sup>16</sup> The savings were attributable to the fact that pay and benefits for county employees were higher than market costs and the employees’ union negotiated contracts on behalf of general employees based on seniority and not specific job descriptions.

Some policy makers have considered privatizing the day-to-day management of their airports due to an ideological conviction and belief that the private sector can do a better job of managing airports by improving the efficiency of operations, establishing new retail and restaurant operations, introducing creativity and innovation, and realizing lower construction costs. However, others argue that airport owners and their tenants would be better served if cost and quality were the criteria used in deciding to privatize, rather than ideology.

Regarding procurement regulations, in some cases the contractor must follow the airport owner’s procedures. For example, in Indianapolis, BAA was not released from the requirements of the Authority’s procurement ordinances when acquiring services on behalf of the airport authority. Release from these procurement regulations is often a large motivation in privatization efforts. In contrast, BAA’s procurement of goods with their own operating funds was not considered ‘public’ dollars in the same way as the authority’s funds.

### 4.4.2 Advantages

The main advantages provided by management contracts include:

- Provides opportunity for airport to be managed and operated as a business
- Streamlines day-to-day operational decision making
- Affords potentially lower operating expenses from private sector employment practices and efficiency initiatives
- Brings increased emphasis on revenue enhancement, commercial, and economic development
- Reduces ongoing municipal employee compensation, including post retirement expenses (pension, medical, etc.)

<sup>16</sup>Kyla King, *The Grand Rapids Press Board votes to outsource parking operations at Grand Rapids airport*, Grand Rapids Press, December 15, 2010.

- Provides greater incentives for management and employees to perform better
- Provides more commercial and operational freedom for contractor

#### 4.4.3 Disadvantages

The main disadvantages provided by management contracts include:

- Involves considerable time and effort for the bidding process
- Could involve buyouts and compensation for existing public workers
- Could involve organizational disruption (i.e., reassignment or termination of existing employees)
- Difficult to truly measure efficiencies for the purpose of justifying compensation
- Can discriminate against government departments competing in managed competition efforts, as regulations generally prevent them from partnering with private firms or guaranteeing performance
- Requires careful tracking of contract compliance, which can be a time consuming and substantial undertaking for the airport owner
- Becomes increasingly difficult to attain further improvements and realize the full value of the management fee once initial efficiencies are attained

Regarding the Indianapolis management contract, the airlines felt that while there were benefits at the front end of the contract, toward the end of the lease, the airport and airlines were questioning the significant payments to the contractor with diminishing or no additional benefits.

#### 4.4.4 Complexity, Risk, and Implementation Issues

Implementing airport-wide management contracts for the first time can be complicated endeavors, but if structured properly, they usually entail relatively low risk. For airports that have operated under management contracts for many years (e.g., Burbank, Albany), the renewal and rebidding of the service is not very complicated, but for airports that consider this form of privatization for the first time, the level of effort can be quite significant, as described in the Indianapolis case study. Among other things, the airport owner needs to:

- Identify what functions it wants to retain and control
- Identify the service quality and performance standards it wants to achieve

- Determine whether a concession or management agreement best advances the airport owner's goals for risk allocation and compensation
- Develop a strong, performance-based contract that holds the contractor accountable for meeting the quality and performance standards
- Address labor issues (i.e., develop strategies to help public employees find other jobs or make the transition to a private-sector environment)
- Develop and issue a request for proposals
- Evaluate proposals and select the winning operator
- Negotiate the terms of the contract
- Secure FAA approvals for the contract, if required
- Oversee the transition from public to private operation
- Monitor the contractor's performance
- Negotiate the annual fee (if the fee is performance-based)

The metrics used to gauge performance need to be transparent and easily measurable. For example, as found in the Indianapolis case study (Chapter 9), improvements made by the contractor (BAA) as measured by airline payments per enplaned passenger were difficult to track because they required estimates of a hypothetical baseline comparison. The baseline became increasingly difficult to measure, especially after the operational changes due to increased security measures following the September 11, 2001 terrorist attacks. As a result, the annual management fee became an annual negotiation between the airport authority and BAA, which was frequently contentious. In addition, tracking contract compliance became a substantial undertaking for the airport authority, which eventually hired professionals with airport and public management expertise to oversee the contract.

Also, the compensation needs to be tied to each goal the airport owner is trying to achieve (e.g., lower costs, enhanced nonairline revenues, improved customer service, new air service). For example, in Indianapolis, the structure of the initial compensation calculation dis-incentivized BAA from implementing any customer service initiative that resulted in increased operating expenses, even though improved customer service was cited as a goal during the competitive bidding process and was supported by the spirit of the management contract. Therefore, there needs to be reliable and accurate cost data to assess the overall performance of the activities and the owner needs to monitor and evaluate performance of the operator to ensure that its expectations are met.

As found in Indianapolis and implemented in Albany and Burbank, to achieve the full benefits of privatization, it may be more effective and economical to contract with multiple firms specializing in each area in which improvement is targeted (e.g., ARFF, parking, fueling, fixed-based operations).

## CHAPTER 5

# Developer Financing and Operation

### 5.1 Specific Strategies

#### Traditional Approach

U.S. airports have traditionally financed airport improvements with a combination of federal and state grants, PFC revenues, customer facility charge (CFC) revenues, internal capital funds, and the proceeds of bonds. Under this traditional approach, airports are able to maintain control of investments, set standards and perform maintenance, and pursue ongoing capital investments that are consistent with community needs, goals, and objectives. Airports are able to access capital markets efficiently at relatively reasonable prices and implement fees on tenants to recover costs of investments in airport infrastructure that help secure funding when required. Issuing bonds may require management actions to increase revenues, reduce expenses, and minimize other capital investments with an overall goal to avoid material impacts on the credit fundamentals of the airport through the period of investment.

Publicly operated airports in the United States also have typically used a design-bid-build process, which gives the airport owner more control over the project, but more exposure to cost overruns and delays as well as increased debt.

#### Project Finance Approach

A number of airports have utilized the private sector for full-scale development, operation and maintenance services, and sometimes financed facilities under long-term leases or concessions. This type of arrangement tends to be used when relatively large investments are needed for passenger terminals, parking garages, rental car facilities, fuel systems, cargo facilities, general aviation facilities, and other major facilities. At the end of the lease, the ownership and control reverts to the airport owner. Project financing is the most common way to introduce private sector capital while also transferring the

risk of repayment. The developer could be entirely private or part of a PPP. Under variants of each model, the developer takes the full economic risk for the investment and operations of the facility. This structure requires that the project have a revenue stream to repay the debt.

There are a number of project development privatization models with different degrees of control and risk for the airport owner, which are summarized in Table 5.1 and described below.

- **Construction Manager at Risk (CM at risk)** is a project delivery method in which a construction manager commits to deliver the project within a guaranteed maximum price (GMP). The construction manager acts as consultant to the airport owner in the development and design phases and as a general contractor during the construction phase. Due to the financial commitment, the CM at risk has an incentive to manage and control construction costs to not exceed the GMP.
- **Master Terminal Concession Developer** is a program management approach in which a developer acts as the airport owner's master lessee and is responsible for developing and managing terminal concession and retail activities, including merchandising, retail, food and beverage, and sometimes advertising services. Typically, the developer is not authorized to operate terminal concessions except in the case of a vacancy. The airport owner and developer share in the revenues under various formulas. Often the developer is required to contribute to a repair and replacement fund to cover certain repair and replacement costs. Examples include Pittsburgh International Airport, Boston Logan International Airport (Terminals B and E), Baltimore/Washington International Thurgood Marshall Airport, and Cleveland Hopkins International Airport.
- **Parking Concession Agreements** are a program management approach in which a private contractor is typically

Table 5.1. Project finance approaches.

Approach	Design	Build	Operate & Maintain	Finance	Transfer at End of	
					Construction	Lease
Construction Manager at Risk	◆	◆			◆	
Terminal Concession Developer	◆	◆	◆	◆		◆
Parking Concession Agreements	◆	◆	◆	◆		◆
Design-Build-Operate-Maintain	◆	◆	◆			◆
Build-Transfer-Operate		◆	◆		◆	
Build-Operate-Transfer		◆	◆	◆		◆
Design-Build-Operate-Transfer	◆	◆	◆			◆
Design-Build-Operate-Maintain and Finance	◆	◆	◆	◆		◆

responsible for all aspects of day-to-day parking operations, including shuttle buses, facility maintenance, and fee collections. As payment for their services, the contractor receives a percentage of the gross revenues from parking operations, but is required to pay the greater of this percentage amount or a minimum annual guaranteed amount to the airport owner. Therefore, the contractor assumes most of the risk for potential downturns in parking revenues, but also receives greater rewards if there is an unexpected increase in airline passenger traffic. Examples include the airports serving Baltimore/Washington, Dayton, Cleveland, Erie, Honolulu, and Houston (Intercontinental).

- **Design-Build-Operate-Maintain (DBOM)** is a project delivery method in which a single contractor is responsible for designing, constructing, operating, and maintaining a facility with financing secured by the airport owner. The airport owner maintains ownership and retains a significant level of oversight of the operations (as set forth in the contract). Under this model, the risk for construction cost overruns and responsibility for annual operating expenses belongs to the contractor.
- **Build-Operate-Transfer (BOT)** is a project delivery method in which a contractor builds a facility to the specifications set by the airport owner, operates the facility for a specified time period, and then transfers the facility to the airport owner at the end of the contract. In most cases, the contractor will also provide some, or all, of the financing for the facility. Therefore, the term of the contract must be sufficient to enable the private partner to realize a reasonable return on its investment through user fees.
- **Build-Transfer-Operate (BTO)** is a project delivery system similar to the BOT model except that the transfer to the airport owner takes place at the time construction is completed, rather than at the end of the lease period.
- **Design-Build-Operate-Transfer (DBOT)** is a project delivery method in which a contractor partner designs, constructs, and operates a facility and hands over ownership of the facility to the airport owner after operating it for a

specified period of time. Under this model the responsibility for construction cost overruns and annual operating expenses belongs to the contractor.

- **Design-Build-Operate-Maintain and Finance (DBOM/F)** is a project delivery method in which a contractor also is responsible for financing the project. Most examples of airport project finance transactions in the United States involve special purpose facilities for single or multi-tenant use, typically an airline, one or more cargo tenants, or rental car companies. The revenues from such special purpose facilities are pledged to pay debt service on the obligations incurred for such special purpose facilities and are not included in general airport revenues. Project finance is also used on behalf of private, third parties that are not tenants of the facilities. Variations and examples of the DBOM/F approach for airports include:
  - **Public-Private Partnership for Terminal Development** is a project delivery method in which a special purpose limited liability corporation (LLC) is formed to build, operate, develop, and manage a terminal under a long-term lease. The developer is obligated to pay operation and maintenance expenses and ground rent to the airport, make facility rental payments sufficient to pay debt service on the bonds, and share distributions from remaining revenues with the airport owner. An example is the \$1.4 billion Terminal 4 at John F. Kennedy International Airport.
  - **Single Tenant Special Facility Terminal Lease** is a project delivery method in which an individual airline finances the construction of portions of or entire terminals. Typically, these improvements are financed under special facility bonds arrangements to allow the airline to access tax-exempt private activity debt to lower the financing costs. Under special facility bonds, the debt is issued by either the airport owner or another governmental entity, which maintains the public purpose of the project and allows the bonds to be treated as tax-exempt debt. The conduit issuer

- retains no contingent liability for the bonds because the bonds are secured solely by special facility rentals and sometimes a corporate guarantee by the tenant. Airline special facility bonds have been used to finance hangar and maintenance facilities, cargo buildings, and ground equipment support facilities for the exclusive use of an airline. Examples include Boston Logan (Delta/Terminal A, US Airways/Terminal B), Chicago O'Hare (United/Terminal 1), Cincinnati Northern Kentucky (Continental/Terminal 3 and Concourse B), Cleveland Hopkins (Continental/Concourses C and D), Los Angeles (American/Terminal 4, Delta/Terminal 6), Newark (Continental/Terminal C), New York's John F. Kennedy (United/Terminal 7, American/Terminal 8), and San Francisco (United/Terminal 3), among others.
- **Multi-Tenant Special Facility Terminal Lease** is a project delivery method in which an airline consortium has financed an entire terminal, including Terminal One Group Association (TOGA) at JFK and Terminal 5 at Chicago O'Hare (the international terminal).
  - **Special Facility Fuel System Leases** are a project delivery method in which a special purpose corporation is created for the exclusive purpose of developing and operating the jet fuel storage and distribution system at an airport under a long-term fuel system lease. Membership in the consortium is open to all airlines serving the airport that accept the interline agreement, receiving fueling services on a non-discriminatory basis. The fuel consortium collects user fees from all air carriers using the facility. Fees are calculated on a residual basis to pay operating expenses, facilities rent (i.e., debt service), and ground rent. Charges are pro-rated primarily based on gallons of fuel delivered. Consortium airlines receive lower rates (non-members typically pay a 50% premium), but are subject to a residual interline agreement, which has a step-up provision that requires members to loan the fuel consortium their share of a defaulting member's unpaid amount. Examples include Boston Logan International Airport, Los Angeles International Airport, Oakland International Airport, Orlando International Airport, and San Francisco International Airport.
  - **Second Party Cargo Development** is a project delivery method in which an airport enters into a long-term ground lease with a cargo integrator such as FedEx and UPS. For example, at the primary express cargo hubs in Memphis and Louisville, cargo processing facilities have been financed primarily through special facility bond financing secured by FedEx and UPS, respectively. However, in both instances a substantial amount of general airport revenue bond debt also was issued for airfield, land acquisition, and other related facilities that were critical to the cargo carriers' operations.
  - **Third Party Cargo Development** is a project delivery method in which an airport owner enters into a long-term ground lease (typically 30 years) with a third party developer to design, construct, and operate a cargo handling facility. In some cases the third party develops the cargo facility for a single tenant where the term of the tenant's lease may or may not be coterminous with the third party's lease.
  - **Private Development of Consolidated Rental Car Facility** is a project delivery method in which a private developer, on behalf of the rental car companies, takes the lead on the design, construction, and financing of the project. The project is financed with special facility revenue bonds that are secured solely by CFCs charged to rental car patrons and sometimes rent paid by the rental car companies.<sup>17</sup> Examples include Ted Stevens Anchorage International Airport and Austin-Bergstrom International Airport. This is a relatively new variation on the more traditional approach where the airport owner takes the lead in designing, financing, and constructing the facility that is financed with standalone CFC debt. Under private development, the airport owner helps to define the scope, but does not take responsibility for the development or delivery of the facility. This is seen as a means to expedite the project delivery and transfer the construction risk to the private developer.
  - **Private Parking Development** is a project delivery method in which an airport awards a long-term contract to a contractor for the development and operation of airport parking facilities. Under the terms of these contracts the contractor may be responsible for designing, building, operating, and maintaining the public parking facilities, or some combination of these tasks. The lease typically provides that the contractor (1) make scheduled minimum annual payments to the airport owner as well as additional payments based on performance and (2) guarantee payment of the debt service from bonds issued to develop parking facilities (usually special facility bonds). Given the significant profit derived from parking operations, this is not a common approach, but has been used in Gulfport-Biloxi, Hartford, New Orleans, and Providence.
  - **Private Solar Development** is a project delivery method in which an airport awards a long-term contract to a contractor to design, finance, install, and operate solar photovoltaic systems on the airport, which generate

<sup>17</sup>A rental car Customer Facility Charge (CFC) is a per transaction day, or a per transaction, charge imposed on the rental car customer by the airport, collected by the rental car companies, and remitted by the rental car companies to the airport. Imposition of a CFC has been key to the financing of consolidated rental car facilities.



power for the airport's use and the airport owner agrees to purchase the power at a fixed rate for the period of the contract through a power purchase agreement or PPA. Airports can realize significant reductions in power costs under these arrangements, although some airports have undertaken solar development themselves to realize these gains, which include renewable energy credits or RECs. Typically the economics of these developments only work for the contractor if it is able to access federal investment tax credits (or grants) for the capital cost of the project. The term of these agreements tends to be 15 to 20 years, which is the economic life of the panels. The solar photovoltaic systems require large amounts of space on an airport, but are placed in areas that do not interfere with the airport's operations. This type of arrangement has been used at airports serving Denver, Fresno, and Bakersfield.

## 5.2 Examples of Developer Financing and Operation

There has been a wide variety of developer financing and operation employed in the United States as illustrated by the following examples.

### 5.2.1 Single Tenant Special Facility Terminal Leases

Individual airlines have privately financed the construction of portions of or entire terminals, including at:

- Boston Logan (Delta/Terminal A, US Airways/Terminal B)
- Chicago O'Hare (United/Terminal 1)
- Cincinnati Northern Kentucky (Continental/Terminal 3 and Concourse B)
- Cleveland Hopkins (Continental/Concourses C and D<sup>18</sup>)
- Los Angeles (American/Terminal 4, Delta/Terminal 6)
- Newark (Continental/Terminal C)
- New York's John F. Kennedy (United/Terminal 7, American/Terminal 8)

Typically these improvements are financed under special facility bonds arrangements to allow the airlines to access tax-exempt private activity debt to lower the financing costs. Under special facility bonds, the debt is issued by either the airport owner or another governmental entity, which maintains

the public purpose of the project and allows the bonds to be treated as tax-exempt debt. The conduit issuer retains no contingent liability for the bonds because the bonds are secured solely by special facility rentals and sometimes a corporate guarantee by the tenant. Airline special facility bonds have been used to finance various types of facilities, including unit terminals or portions of passenger terminals, hangar and maintenance facilities, cargo buildings, and ground equipment support facilities for the exclusive use of the airline.

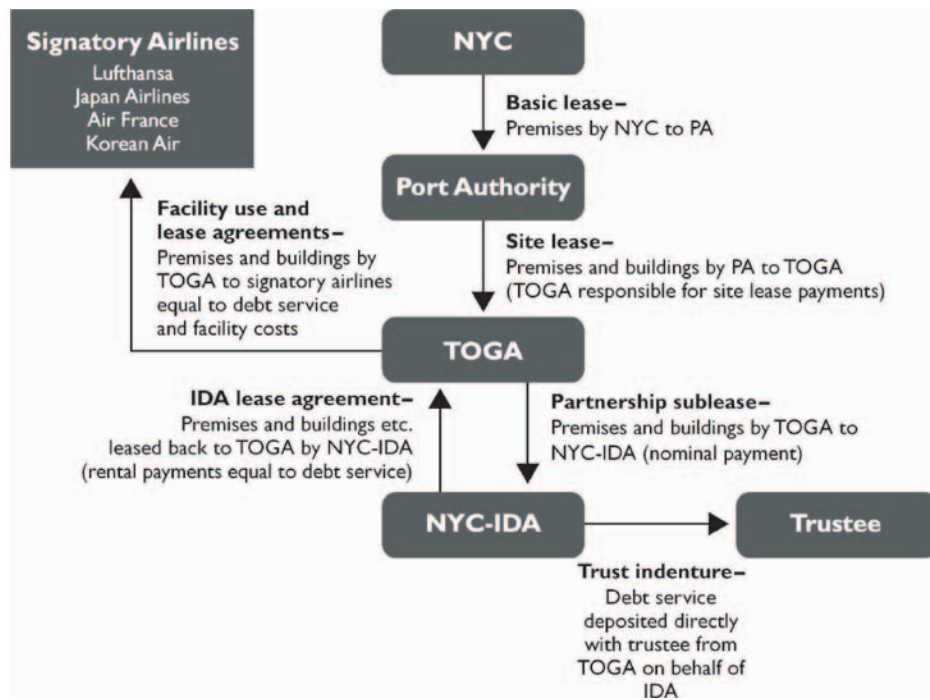
During the most recent round of airline bankruptcies in 2003 and 2004, a number of these special facility bond leases were rejected by certain airlines under the Chapter 11 bankruptcy laws while the associated ground leases were accepted resulting in a situation where the airline continued to use the facility and only pay ground rent but not debt service. This action on the part of the bankrupt airlines, led to a series of lawsuits by bondholders. (See Section 5.4.3 for more detail.)

Although there have been fewer issues of single tenant special facility financings since these lawsuits, the outcomes from these lawsuits have provided guidance on how leases should be structured in the future to avoid such a re-characterization in a bankruptcy setting. For example, in December 2009 there was a \$150 million special facility bond financing for Delta Airlines to refinance bonds issued in 2000 that were used to fund the costs of acquisition, construction, and installation of certain airport facilities for Delta at Atlanta Hartsfield International Airport. In addition, in August 2010, there was a \$30 million financing for US Airways' facilities at Philadelphia International Airport (ground support equipment maintenance facility, cargo improvements, terminal baggage handling systems, and updating and renovating offices and crew rooms).

### 5.2.2 Multi-Tenant Special Facility Terminal Leases

In some cases, airline consortiums have financed entire terminals, including TOGA at JFK and Terminal 5 at Chicago O'Hare (the international terminal). TOGA was formed as a limited partnership to lease, finance, construct, maintain, and operate Terminal One at JFK Airport. The facility, which serves international passengers only, was completed on time and within budget in 1998. TOGA is owned by four airlines, each holding an equal interest in the partnership—Lufthansa, Japan Airlines, Air France, and Korean Air. The tax-exempt special facility bonds for Terminal One were issued by the New York City Industrial Development Agency (IDA) on behalf of TOGA. As part of the financing, TOGA entered into a site lease with the Port Authority of New York and New Jersey for the Terminal One site. The four airline partners entered into individual facility use and lease agreements with

<sup>18</sup>In the development of Concourse D at Cleveland in 1997, the City decided it wanted to retain the right to award the concessions in the new concourse. Therefore, the non-airline areas of the concourse were financed with general airport revenue bonds and are not part of Continental Airlines' special facility leased premises.



Source: "New York City Industrial Development Agency's (IDA) special facility revenue bonds series 2005, issued for the Terminal One Group Association LP (TOGA)," Standard & Poor's Ratings Services, October 31, 2005.

**Figure 5.1. Terminal One Group Association transaction legal structure.**

TOGA. These airlines are ultimately responsible on a joint and step-up basis for paying all of the facility's fixed and variable costs, including debt service on the special facility bonds that financed the terminal. Terminal One was developed as a multi-use airline terminal with 640,000-square feet and 11 aircraft gates, and is one of nine airline terminals located within JFK's central terminal area complex. The lease structures to accomplish these transactions can be quite complicated as illustrated in Figure 5.1.

### 5.2.3 Special Facility Fuel System Leases

BOSFuel is a special purpose corporation created for the exclusive purpose of developing and operating the jet fuel storage and distribution system at Boston Logan International Airport under a fuel system lease that expires in 2039. Membership in the consortium is open to all airlines serving the airport that accept the interline agreement, while fueling service is available to all carriers serving the airport on a non-discriminatory basis. BOSFuel collects user fees from all air carriers using the facility, calculating the fees on a residual basis to pay operating expenses, facilities rent (i.e., debt service), and ground rent. Charges are pro-rated primarily based on gallons of fuel delivered. Consortium airlines receive lower rates (non-members pay a 50% premium), but are subject to a residual interline

agreement, which has a step-up provision that requires members to loan BOSFuel their share of the unpaid amount if any member defaults. In 2009, there were more than 20 airline members of BOSFuel, accounting for over 90% of total fuel volume at the airport.<sup>19</sup>

Similarly, SFO Fuel Co. LLC (SFOFuel) is a single-purpose, limited liability company that was created in 1997 to lease, construct, operate, and maintain the exclusive jet fuel facilities at San Francisco International Airport. The company issued bonds totaling approximately \$125 million to construct improvements to the consolidated fuel distribution facility. Like BOSFuel, the special facility bonds are secured solely by payments to the Airport Commission by SFOFuel from facilities rent collected from the airlines, including an unlimited step-up provision for the sharing of capital and operating expenses among the 40 member airlines in the event of any member default.

A number of other airports have similar airline fuel system consortia that were created to develop and operate jet fuel systems, including Los Angeles International Airport, St. Louis International Airport, and Anchorage International Airport.

<sup>19</sup>Fitch Downgrades \$103MM MassPort Rev Bonds for BosFuel to 'BBB' from 'A-'; Outlook Stable, The Bond Buyer, February 10, 2010.

### 5.2.4 Third Party Cargo Development

Cargo facility development can be accomplished by (1) the airport owner, (2) a second party who develops and subsequently occupies and uses the facility, (3) a third party who develops the facility but does not occupy or use it, (4) a contractual arrangement where the development and management of the property is shared by the public and private sectors, or (5) a combination of these strategies.

Third party airport cargo development is quite prominent in the United States today across all airport sizes and forms of governance, including at Boston Logan, Chicago O'Hare, Dallas–Fort Worth, Harrisburg, JFK, Miami, Pittsburgh, San Antonio, Seattle, Washington Dulles, and others. Airports enter into long-term ground leases (typically 30 years) with third party developers to design, construct, and operate a cargo handling facility. The third party finances the cargo building and associated truck dock and vehicular parking while the aircraft apron and road improvements are usually funded through a combination of federal, state, local, and private funds. Often the third party financing is accomplished with tax-exempt special facility bonds issued by the airport or another public agency on behalf of the third party developer. These special facility revenue bonds are repaid solely from revenues generated by the facility, as collected by the third party developer from tenants of the project. The rating for these bonds is based on the financial strength of the tenant, guarantees of a third party (e.g., bond insurer), or the level of demand for cargo facilities and the availability of other facilities on or near the airport instead of the airport as a whole. As a result, these bonds carry a higher interest rate than general airport revenue bonds.

There are three types of third party cargo financings—single tenant, multi-tenant, and pooled assets.

- **Single Tenant:** There are a number of examples of cargo financings accomplished under long-term leases with integrators such as FedEx and United Parcel Service (UPS). For example, at the primary express cargo hubs in Louisville and Memphis, cargo processing facilities have been financed primarily through special facility bond financing secured by UPS and FedEx, respectively. However, in both instances a substantial amount of general airport revenue bond debt also was issued for airfield, land acquisition, and other related facilities that were critical to the cargo carriers' operations.
- **Multi-Tenant:** Multi-tenant cargo financings, on the other hand, often involve shorter term leases with a number of cargo operators and freight forwarders and usually these bonds are unrated and privately placed. In one of the larger multi-tenant third party cargo developments, the City of Denver, the owner and operator of Denver International

Airport, entered into a 30-year ground lease with a third party developer, WorldPort at DIA Owners LLC, to design, construct, and operate a cargo handling facility on 70 acres of airport property in 2000. The proposed \$100 million cargo development (called WorldPort at DIA) was envisioned to consist of seven buildings (500,000 square feet), a new taxiway, and an aircraft ramp to be developed in phases. Two 60,000-square-foot buildings were completed in 2002, but as of 2010 only one of them had tenants. The other buildings were never constructed. The city issued special facility bonds to finance the construction on behalf of the developer, but those bonds were paid off. In 2008, the city paid JPMorgan Chase \$4 million for WorldPort, which represented 12.5% of the estimated \$32 million that former owner Lehman Brothers invested in the project. Lehman was the project's initial primary investor, but Lehman transferred WorldPort to JPMorgan Chase, which had guaranteed the bonds used to build WorldPort. WorldPort opened right after the Sept. 11, 2001, terrorist attacks, which led to a decline in air cargo shipments both in Denver and nationwide that contributed to the lack of tenants along with a fundamental shift to integrators (e.g., FedEx and UPS) who began to transport more freight by truck instead of air.

- **Pooled Assets:** The first pooled asset special facility cargo financing took place in 2002 when Cargo Acquisitions Companies Obligated Group, consisting of Aeroterm US Inc. and its financial partner Greenfield Partners (a private equity fund in Norwalk, Conn.) sold \$73.5 million to finance the acquisition of long-term leases from other third party developers at nine different airports. Combining the financing for cargo leases at nine airports into a single cross-collateralized bond issue permitted an investment grade rating. If the lease acquisitions had been financed individually, the bonds most likely would not have been rated. According to Mary Francoeur, senior vice president of Moody's at that time: "It removes a single asset risk that would normally be associated with one cargo property. It gives the structure some diversity."<sup>20</sup>

Another noteworthy cargo facility development at Washington Dulles Airport involved a unique financing arrangement between the Metropolitan Washington Airports Authority (MWAA) and AFCO (the cargo developer). Under the 24-year lease, MWAA loaned AFCO \$2 million for infrastructure improvements as part of the development (in addition to special facility financing for the cargo building) where the amortization of the loan principal and interest were not payable

<sup>20</sup>Michael McDonald, *Unprecedented Air Cargo Deal Uses Nine Separate Authorities*, The Bond Buyer, March 12, 2002.

until years 16 through 24 when the developer was in a position of making a profit on the development.

### 5.2.5 Private Development of Low-Cost Airline Terminal Development

In 2007, the City of Austin, the owner and operator of Austin-Bergstrom International Airport, recognized an emerging niche and marketing opportunity and set out to attract an ultra-low-cost Mexican airline, after seeing the implementation of this successful airline business model in Europe (Ryanair) and Asia (AirAsia) and the debut of Skybus in the United States. After contacting Mexican airline VivaAerobus, the airport realized that to compete for their service, the city would need to provide a low-cost, no frills terminal as an alternative to the existing terminal that catered to full-service airlines.

The city had two primary goals in developing this new facility—(1) it needed to be constructed quickly to respond to this market opportunity and (2) it wanted to reduce its risk in the event the airline was not successful or stopped serving the airport. Therefore, the city decided to enter into a partnership with General Electric’s subsidiary, GE Commercial Aviation Services (GECAS), to develop and operate a no frills, one-story terminal building (previously owned by the National Guard) with no jetways or complex baggage system and with common use holdrooms, gates, and ticket counter areas. GECAS also operated the parking and rental car facilities at the terminal, while the city operated the airfield and security. Due to the lower level of service provided at the South Terminal, rental rates were priced at roughly half of the rates paid by the airlines in the main terminal. However, all airlines paid the same landing fee rates. The 20-year lease between the city and GECAS was structured to allow GECAS to recoup its \$6 million investment in the South Terminal facilities before the city would begin sharing in the revenues.

In May 2008, the low-cost, no frills South Terminal opened as the first facility constructed in the United States dedicated to accommodate ultra low-cost airlines. However, the negative impact on air travel resulting from a combination of the swine flu virus, the deep economic recession, and Mexican drug wars caused VivaAerobus to suspend its service from Austin in June 2009 and GECAS turned the facility back to the city. Although the South Terminal has been temporarily closed until a new ultra-low-cost carrier can be recruited to begin service, the city achieved its goals of speedy development of the facility to exploit a marketing opportunity and minimal financial risk by engaging a private company to participate in this development venture.<sup>21</sup>

<sup>21</sup>Interview with Jim Smith, Airport Director of Austin-Bergstrom International Airport, August 12, 2010; and *ACRP Report 20: Strategic Planning in the Airport Industry*, January 2010.

### 5.2.6 Private Development of Consolidated Rental Car Facility

**Ted Stevens Anchorage International Airport.** In 2005, Venture Development Group, LLC (an Alaska commercial real estate development company), contracted to develop a new \$57 million consolidated rental car facility at Ted Stevens Anchorage International Airport under the terms of a memorandum of understanding with the rental car companies operating at the airport, the state of Alaska (the owner and operator of the airport), and the Alaska Industrial Development and Export Authority. Venture Development was responsible for the design, construction, and delivery of the project and the Alaska Industrial Development and Export Authority issued the taxable revenue bonds used to finance the facility. The bonds are payable solely from and secured by a pledge of the revenues derived from the daily CFC collected by the rental car companies from their customers, and certain funds and accounts held by the trustee under the bond trust indenture. The state rented the development site to the Anchorage RAC Center, LLC, an Alaska limited liability company and special purpose entity, which manages, operates, and maintains the consolidated facility for use by the rental car companies under subleases.<sup>22</sup>

**Austin-Bergstrom International Airport.** Since its opening in 1999, rental car staging and ready return space have been located on the third level of the terminal parking garage at Austin-Bergstrom International Airport. These facilities were financed with taxable special facility revenues bonds paid for with rental car CFCs. Each rental car company also operates a remote, on-site service center, located approximately one mile northwest of the terminal. The first two levels of the garage are used for public parking. As passenger traffic increased, it became apparent that there was a need for additional rental car staging and ready return space as well as additional covered public parking within walking distance to the terminal building.

In 2010, airport officials and rental car company representatives mutually agreed that the best way to solve the issue was to build a new, three or four level parking garage and consolidated rental car facility on a surface parking lot located immediately behind the existing terminal parking. This will allow the airport to convert the third floor to public parking and to develop a consolidated facility for rental car ready return and quick turnaround areas (vehicle fueling, cleaning and storage facilities) within walking distance to the terminal

<sup>22</sup>*Official Statement, Alaska Industrial Development and Export Authority, Taxable Revenue Bonds (Rental Car Facility Project at Ted Stevens Anchorage International Airport)*, September 2005.

to avoid the need for busing of rental car customers and to reduce the need for the rental car companies to ferry vehicles back and forth between the terminal and the remote service centers. The rental car companies requested permission to take the lead on this project, using a public–private partnership business model. The city agreed to allow the rental car companies to lead the design, construction, and financing of this project to expedite the project delivery. It is expected that the facility will be funded with special facility revenue bonds secured by the CFC revenues.<sup>23</sup>

### 5.2.7 Public-Private Partnership for Terminal Development

JFKIAT was formed in 1997 in partnership with the Port Authority of New York and New Jersey, to build, operate, develop, and manage the new \$1.4 billion Terminal 4 at John F. Kennedy International Airport to replace the old International Arrivals Building (IAB) that had been operated by the Port Authority since 1957. Initially JFKIAT was a joint venture of LCOR JFK Airport LLC, Schiphol USA Inc., and Lehman JFK LLC, but is now owned by Schiphol USA (a Schiphol Group Company) and Delta Air Lines, which bought a non-majority, non-controlling stake in JFKIAT in April 2010. JFKIAT assumed responsibility for the operation of the IAB and development of the new terminal in April 1997 concurrent with the financial closing of the special facility bonds issued to finance the project. The lease term expires 25 years after the date of beneficial occupancy of the new facility. The 1.5-million square-foot Terminal 4 opened at JFK in May 2001. Under the lease with the Port Authority, JFKIAT is obligated to pay certain operation and maintenance expenses and ground rent to the Port Authority, make facility rental payments sufficient to pay debt service on the bonds, and distributions from remaining revenues. Unlike the cost-recovery pricing methodology used at most U.S. airports, JFKIAT imposes differential pricing that recognizes the value to airlines of access to the facilities during peak periods and the value to JFKIAT of longer term, fixed lease commitments. These rates are generally set to reflect market-based competitive rates for rents and fees.<sup>24</sup> Terminal 4 is one of the largest terminals in the New York area serving 40 international and domestic airlines and 9.5 million passengers in 2009.<sup>25</sup> JFKIAT is the only private, nonairline company to operate a terminal at JFK.

<sup>23</sup>Interview with Jim Smith, Airport Director of Austin-Bergstrom International Airport, August 12, 2010; and Austin City Council Agenda, Aviation item No. 5, Recommendation for Council Action, July 29, 2010.

<sup>24</sup>Official Statement, *the Port Authority of New York and New Jersey, Special Project Bonds, Series 6*, JFK International Air Terminal LLC Project, April 25, 1997.

<sup>25</sup>JFKIAT, *LLC News Release*, July 28, 2010.

In August 2010, the Port Authority announced its approval of a \$1.2 billion expansion of Terminal 4 to accommodate Delta’s international operations. The project includes expanding Concourse B at Terminal 4 to add nine new international gates, constructing a passenger connector between Terminal 2 and Terminal 4, expanding areas for baggage claim and Customs and Border Protection, and demolishing Terminal 3. The existing Terminal 3 site will be used for aircraft parking. Delta also would continue to use Terminal 2 for domestic operations. The project would be financed with about \$900 million of special project bonds (secured by the lease on the expanded terminal), \$75 million of equity from Delta, \$215 million of PFCs, and TSA grants.<sup>26</sup>

### 5.2.8 Private Parking Development

Although most airport owners finance parking facilities using airport funds or bonds, a few airports have awarded long-term contracts to private entities for the development and operation of airport parking facilities (e.g. Gulfport-Biloxi, Hartford, New Orleans, and Providence). Under the terms of these contracts the private entity may be responsible for designing, building, operating, and maintaining the public parking facilities, or some combination of these tasks.

The primary reasons for considering this type of an arrangement include:

1. To improve net revenues and preserve airport capital by developing new parking facilities without using airport funds,
2. To receive a large up-front payment,
3. To reduce airport staff time required to oversee and/or manage the parking operation, and/or
4. To reduce risks associated with funding new parking facilities using airport-supported bonds.<sup>27</sup>

**Bradley International Airport.** On April 6, 2000, the State of Connecticut (the owner and operator of Bradley International Airport serving Hartford, Connecticut) issued \$47.7 million in conduit special facility parking revenue bonds to finance the costs of a new parking garage. In connection with issuance of these bonds, the state entered into a parking lease under which the parking operator (APCOA/Standard Parking, Inc.) was obligated to construct and operate the parking garage as well as all state-owned surface parking facilities through 2025.

<sup>26</sup>Port Authority of New York and New Jersey, *Committee on Operations, Minutes of Special, Interim Meeting*, August 5, 2010; and N.Y.-N.J. *Port Authority Approves JFK Terminal Expansion*, The Bond Buyer, August 6, 2010.

<sup>27</sup>ACRP Report 24: *Guidebook for Evaluating Airport Parking Strategies and Supporting Technologies*, October 2009.

The lease provides that APCOA make scheduled minimum annual payments to the state and additional payments based on performance. Under the terms of the parking lease, APCOA has guaranteed payment of the debt service from the parking garage bonds and the scheduled annual payments to the state. The state has not pledged any airport revenues towards this debt.

### 5.2.9 Airport Industrial Park Development

Alliance Airport was developed in a public/private partnership between the City of Fort Worth, Alliance Air Services, and the FAA. The airport is owned by the City of Fort Worth and managed by Alliance Air Services, a subsidiary of Hillwood Development Company LLC, a real estate development company owned by H. Ross Perot, Jr. Hillwood dedicated 418 acres to the City for airfield (runway/taxiway) use and the surrounding 3,000 acres are privately owned for use as an industrial airport. The airport opened on December 14, 1989 and does not serve passenger traffic.

Although airside-related land use is not profitable, lands devoted to industrial use are the most profitable property on general aviation airports. As a result, Hillwood retained property that would generate more profit than non-airport related industrial land uses (because of the land's association with, and proximity to, the airport). Hillwood donated land for the airport and relied upon the overall success of the land development project surrounding the Alliance Airport, which appears to be succeeding. According to a 2009 report:

Since 1990, approximately 28 million square feet of space has been developed at Alliance, with most owned and managed by Hillwood. The Alliance area houses more than 150 companies and, as of January 2007, created over 27,000 jobs. Much of the development is industrial space to capitalize on the proximity of Alliance Airport. Alliance is far from completion, with only 5,500 developed out of a total of 17,000 acres. At full build-out, the development is projected to house 88 million square feet of commercial space and employ 92,000 workers.<sup>28</sup>

### 5.2.10 Airport Light Rail Extension

In 1997, the Tri-County Metropolitan Transportation District (Tri-Met) and the Port of Portland (Port), owner and operator of Portland International Airport, wished to build a 5.5 mile extension of the existing regional light rail system to the Airport. However, under federal regulations, airport owners can only pay for the portions of air-rail extensions that are on airport property (or right-of-way) and that transport passengers to the airport. A portion of the proposed

<sup>28</sup>Texas Motor Speedway Area Master Plan, Chapter 1: Background, January 2009.

airport extension was off-airport and funding needed to be secured for that segment. Therefore, the Port proposed a creative solution whereby it participated in the rail extension project, which was jointly developed by the Port, Tri-Met, Cascade Station Development Company (Cascade), and the Portland Development Commission (PDC).<sup>29</sup> The extension was segmented into three parts based on financial responsibility:

1. The Port was responsible for the cost of 1.2 miles of track from the airport's Portland International Center (an office and industrial park on airport) and construction of a transit station and a covered center platform on the deplaning level of the terminal, the cost of which totaled \$43 million. The Port used PFC revenues to fund its share of this cost.
2. The second 1.4-mile segment of the Airport MAX project, from the eastern boundary of the airport through the Portland International Center, was funded by PDC in exchange for the right to develop land in the Portland International Center. The development rights were then assigned by PDC to Cascade, which created Cascade Station, a 120-acre mixed-use development with over a million square feet, including retail, hotels, and offices, and was responsible for construction of streets, parking, park areas, an overpass, and other road improvements. The Port agreed to contribute, from funds other than PFC revenue, \$7 million toward the cost of the overpass. Two transit stations, funded from local and regional sources, are located within the Portland International Center.
3. In exchange for the development rights, Cascade pays PDC assignment fees, which PDC assigned to Tri-Met to repay bonds issued by Tri-Met to finance a portion of the remaining 2.9-mile portion of the Airport MAX extension that is located off-airport property.

The Airport MAX opened in September 2001.

## 5.3 Legal and Regulatory Considerations

The primary interests of the U.S.DOT and the FAA are to ensure that the airport owner and the developer comply with relevant legislation, regulations, and policies. Chief among these are compliance with grant assurances, the rates and charges policy, environmental regulations, and PFC regulations (if applicable).

<sup>29</sup>The Portland Development Commission is the urban renewal agency created by the city of Portland to promote development, housing projects, and economic development within the city's urban renewal districts.

Regarding grant assurances and the rates and charges policy, the following requirements are relevant:

1. *Assurance 22* requires the airport sponsor to make the airport available for public use on reasonable terms and without unjust discrimination. Therefore, rates and charges levied on airlines for services and facilities provided by the developer must be “fair and reasonable” and the airlines cannot be subjected to “unjust discrimination” in fees and operating conditions, unless otherwise agreed to by the airline. Because the airport owner must assure compliance with federal statutes, it is necessary for the airport owner to include in the lease the requirement that the developer must provide fair and reasonable fees and avoid unjust discrimination.
2. *Assurance 23* prohibits an airport sponsor from granting an exclusive right to conduct an aeronautical activity at the airport. This prohibition applies only to aeronautical activities. It does not prohibit monopolies in, for example, car rentals, parking, and concessions.
3. *Assurance 24* requires the airport sponsor to impose rates and charges in such a manner and at such levels as to make the airport as self-sustaining as possible under the circumstances. For example, airport sponsors must charge a minimum of fair market value to lease property for non-aeronautical use, but have considerable flexibility, subject to Constitutional standards, to charge higher amounts for rent and other fees.<sup>30</sup>
4. *Assurance 25* requires the airport sponsor to use airport revenue only for the capital and operating costs of the airport, the local airport system, or other local facilities owned or operated by the airport sponsor and which are directly and substantially related to the air transportation of passengers or property. A developer financing transaction would be subject to federal evaluation at least with respect to the self-sustaining assurance to insure the payments to the developer do not exceed the fair and reasonable value of its services or otherwise fail to comply with the Policy Concerning the Use of Airport Revenue. The FAA can investigate if there has been a violation with or without a formal complaint and can issue an order proposing enforcement action (e.g., reasonable rates and charges). Sanctions include, among others, withholding future grants and withholding payments under existing grants.
5. *Grant repayment*—Another consideration is when the proposed development requires the removal or demolition of any improvement funded in whole or in part with

AIP grants. If so, there may be a requirement to repay the federal government for the unamortized value of its investment in the facility or to replace the facility. For example, the FAA consented to the demolition of the IAB at JFK for the Terminal 4 development subject to the requirement that grant-funded facilities in the IAB were replaced with “like or superior” facilities.

6. *Exclusive use*—Any improvement funded with AIP grants cannot be leased on an exclusive use basis to a developer (or any other tenant). For example, if an airport uses AIP grants to construct a cargo apron and enters into an agreement with a developer to construct a cargo building that is contiguous to the apron, the apron cannot be used exclusively by the developer and its tenants.

Regarding environmental requirements, any actions required under the National Environmental Policy Act of 1969 must be completed. For example, if there is a need for an environmental assessment or environmental impact statement, the FAA will need to approve them. In the case of the Terminal 4 development at JFK, the FAA provided a categorical exclusion from the requirement for an environmental assessment and approved an updated airport layout plan including the redeveloped terminal.

In addition, the project needs to appear on an approved airport layout plan (ALP) and the appropriate airspace finding must be made by the FAA.

If PFCs are used to help fund the project, the airport owner must also ensure that the developer complies with all provisions under the PFC regulations (14 CFR part 158). In addition to the environmental, ALP, and airspace requirements noted above, if PFC revenues are used, the developer cannot:

- Enter into an exclusive long-term (defined as five years or longer) lease or use agreement with an air carrier or foreign air carrier for projects funded by PFC revenue
- Include in the rate base (e.g., through depreciation or amortization) that portion of the capital costs of a project paid for by PFC revenue for the purpose of establishing a rate, fee or charge pursuant to a contract with an air carrier or foreign air carrier

It is important to note that each state has its own unique set of laws and regulations. When contemplating privatization options, it is important to undertake a comprehensive review of these laws. For example, as found in the Boston Terminal A case study, given the unique public bidding requirements in Massachusetts, accessing tax-exempt conduit financing for private development was deemed infeasible. Once the airport owner determined that private developers needed tax-exempt debt, it had to seek other avenues for private participation in the project.

<sup>30</sup>Such as the permissive standards applied to privilege fees for rental car companies.

## 5.4 Evaluation of Developer Financing and Operation

The reasons why an airport might consider developer financing and operation include:

- Preserve financial capacity for other essential airport development (e.g., terminals, runways, taxiways, and roadways)
- Avoid unnecessary risks (economic and political)
- Accelerate the development timeline and reduce project costs by avoiding the requirements of public bidding and approval procedures
- Limit the airport's administrative burden and need to hire additional staff to handle facility financing, bidding, design, and construction oversight as well as ongoing marketing, operation, and maintenance expenses

These factors must be tempered by the airport owner's loss of control over the land and facility (tenants, appearance, maintenance, etc.) and the unrealized potential for upside revenue generation, although some of the development leases include revenue sharing provisions.

### 5.4.1 Opportunities

Some of the opportunities cited for developer financing and operation include:

- Reduces reliance on municipal debt and conserves public capital for those areas where public funding is the only alternative
- Transfers risk exposure for cost overruns, delays, and debt repayment to the private sector
- Has potential to reduce operating expenses and increase operational efficiencies due to avoidance of public procurement processes and to private sector motivations and incentives
- Accesses private sector expertise for specialized functions and commercial development
- Attains the latest technical and managerial expertise for the infrastructure project
- Applies private sector techniques to accelerate project delivery and reduce construction costs
- Can enhance commercial development revenues
- Creates/retains jobs for the local economy

### 5.4.2 Advantages

The major advantages cited for developer financing and operation include:

- Preserves general airport revenue bond debt capacity for essential airport development
- Avoids unnecessary risks for airport owner

- Accelerates project delivery and may reduce construction costs

However, as found in the JFK Terminal 4 case study, although the terminal was completed on-schedule, the final project cost was about 20% higher than the budgeted cost.

- May bring about improved efficiency and may reduce ongoing operating expenses, which would provide low-cost facilities to tenants (especially when tax-exempt financing is employed)
- Limits administrative burden of airport and staffing responsibilities for facility financing, bidding, design, construction oversight, marketing, ongoing maintenance, administration, and management
- Minimizes or eliminates delays from local procurement policies that tend to delay contract awards

There is strong sentiment by U.S. airport managers that they can do as good a job, if not better, than private operators if they were unburdened by cumbersome, rigid regulations and processes. Nevertheless, some airport managers expressed frustration with the lack of speed when undertaking public projects and the inherent problems associated with the many local requirements to accept the lowest bid. Under a developer financing transaction, there is no low bid requirement and the project can be constructed on an expedited basis.

- Allows airport management to focus on other strategic issues and assets

### 5.4.3 Disadvantages

The major disadvantages cited for developer financing and operation include:

- Involves considerable time and effort for bidding process and negotiation of complex legal documents
- Requires that the project have a revenue stream to repay the debt
- Provides airport less control over the project and facility management
- Loss of control over the development site and future capacity expansion

As discovered in the JFK Terminal 4 case study, the long-term lease meant that control over the largest terminal site on the airport and the flexibility to respond to changing market conditions was relinquished by the airport owner (the Port Authority of New York and New Jersey or Port Authority). While this factor was not important in the early years of operation, it became a more important consideration later on. From a customer service perspective, replacing Terminal 3 was a top priority for the Port Authority, and expanding Terminal 4 was the logical and most economically viable solution. However, the Port Authority only had indirect influence



- on the outcome of negotiations between Delta and JFKIAT, two parties with competing financial interests.
- Loss of flexibility to change land uses over period of lease
  - Less control over types of activities and quality and appearance
  - Involves considerable upfront planning, time, and expense
  - Involves moderate implementation risk
  - Less control of facility utilization especially under airline-financed terminals that run the risk of inefficient utilization of gates and associated terminal space
  - Could involve organizational disruption and need to reassign or terminate existing employees
  - Could involve buyouts and compensation for existing public workers
  - Involves long-term risk if the project encounters financial problems, i.e., the airport may need to step in (even though it is not financially obligated to do so) to preserve the use of the facility and associated airport capacity
  - Can expose the airport to political, legal, operational, and financial risk if the transaction is not consummated or if the private entity incurs financial difficulties
  - Involves loss of key revenue streams under parking and cargo privatization

#### 5.4.4 Complexity, Risk, and Implementation Issues

Implementing developer finance and operation transactions entails more complexity and risk than service contracts and management contracts. Private financing arrangements in the United States context are generally:

- More complicated to structure because they must be designed in a way that will satisfy airport revenue bond covenants, federal law and FAA regulations, IRS rules, airline concerns, and local political concerns
- Difficult to evaluate relative to public operation
- Involve high transaction and procurement costs
- Require considerable upfront time to arrange

Therefore, private sector development options need to be fairly concrete before they can be evaluated in technical terms and in the context of the airport's goals and objectives.

On the other hand, it generally takes longer to design and bid a facility under airport development than under private development due to the time required to follow government procurement procedures. The magnitude of the time difference depends on the length of the airport's procurement process and the experience of the developer.

There are certain penalties or hurdles that potentially could add costs or limit the effectiveness of private developer approaches, including but not limited to: (1) compliance with AIP grant assurances and PFC regulations (if used),

(2) revenue diversion issues or risks, (3) IRS tax regulations, and (4) bond indenture provisions. Assuming the hurdles can be overcome, the developer will presumably seek a higher rate of return than an airport's cost of capital in the public market, meaning that for the economics of a business deal to work for both parties, the investor may need to achieve efficiencies. Ways a developer may achieve efficiencies include (1) tax benefits, (2) savings on costs of maintenance and operation of the project, (3) revenue efficiencies, and (4) under certain circumstances more efficient access to capital markets or ability to structure debt more creatively.

To structure a developer finance and operation transaction, the developer (if not a single tenant such as an airline) typically forms a special purpose company (usually a LLC) in which they hold shares. The first purpose of the LLC is to construct and operate a new project or to re-finance and operate an existing project. The second purpose is to provide lenders a security of payment of interest and principal from a single operating entity. Because lenders have no recourse except against the cash flow of the project or the project assets, the balance sheet of each member of the LLC is protected in the event the project fails. The members of the LLC can walk away from a project if it becomes uneconomical, especially if it is not strategically essential to the business of its members, and the lenders would have no recourse against them. This lack of recourse is a defining characteristic of project finance.

Because the LLC is (intentionally) financially weak, it alone will not be able to provide lenders the security they seek. To create this security, a LLC will use a credit enhancement facility for the debt (e.g., municipal bond insurance) and negotiate contracts that allocate risk to other entities that are better able and willing to absorb it. The objective is to leave as little risk (pre-construction, construction, and post-construction) in the LLC as reasonably possible in order to provide lenders the security they seek.

Airport special facility financings came under well publicized attention and reevaluation after court decisions in the United Airlines bankruptcy in 2005 and 2006. United claimed that its leases at San Francisco, Los Angeles, John F. Kennedy, and Denver international airports were not "true" leases but were in substance unsecured loans. As a result, United could reduce its payments to the fair market rental rate for the occupied space and treat the remaining amount of principal on the bonds as unsecured debt.<sup>31</sup> The legal agreements supporting special facility bond issues determine the rights and security interests of the issuer, the bond trustee, bond insurer, and the airport operator in the event of a bankruptcy by the tenant airline. In very general terms, if the airline's payment obligations are evidenced in a loan or in a lease that can be

<sup>31</sup>The bond payments were much greater than the fair market rental rate. The lease at Denver was ruled a true lease by the courts.

construed as a loan (often called a disguised financing lease) then the airline can default on the debt. The lease-versus-loan financing distinction is significant because under Section 365 of the Bankruptcy Code “true” leases must be assumed or rejected and the debt must be paid when scheduled, whereas disguised financings often become unsecured claims. Debt under a true lease must be repaid if the company in bankruptcy assumes that lease and doesn’t want to risk eviction from its facilities. Even though the airport owners were not legally required to pay debt service on the bonds, there was pressure from the bondholders to evict the airlines and the airline’s access to the premises was restricted.

As a result, airline special facility financing of unit terminals is likely to have limited application in the future because the rules have changed (since recent airline bankruptcies) and access to capital is more difficult and costly. Some deals are getting done, but they do not have the same economics as they once had. Moreover, there is less certainty now when a deal is started that the financing will be available and affordable.

Possible constraints and other considerations for developer finance and operation transactions might include:

### *Economics of the Business Deal*

- Despite the representations that developers and infrastructure funds are looking for opportunities to invest private capital in airport assets, as discovered in the Boston Terminal A and JFK Terminal 4 case studies, the prospective developers contended that the projects could not be economically financed without significant access to tax-exempt debt or other airport revenues. The JFKIAT developer estimated the tax-exempt financing provided a roughly 30% discount on private financing.
- The underlying credit qualities of a transaction are typically weak due to high leverage, narrow diversification of the asset base, and limited revenue streams that make them more susceptible to event risk. It is generally believed that the underlying credit qualities of developer finance transactions will need to be stronger now than in the past, which will further challenge the feasibility of such a transaction. The cost and limited availability of bond insurance may contribute to the challenge. The experience of Terminal A at Boston and Terminal 4 at JFK highlight the difficulties of financing terminal buildings, with their high capital and operating costs, without the higher-margin parking and rental car revenues.
- Would the management contract oblige the private developer to finance ongoing capital expenditures (a full-service contract)? Such a contract entails more business risk for the developer, which must put up its own cash for maintenance and construction with no guarantee that it will fully recover its capital investment.

- Despite the potential advantages that developer financing and operation may offer, such transactions are expensive and time-consuming to arrange. The effort may be so great or costly that the airport finds the transaction costs are not worth the benefits.

### *FAA Oversight*

- Safeguards to preserve the airport owner’s control over the actions of the LLC might affect compliance with AIP grant assurances and PFC assurances (as noted above in Section 5.3).

### *Tax Status (IRS Tax Regulations)*

- Would a lease of the site/facilities (and potential assignment of revenues) affect the tax-exempt status of any outstanding bonds?

### *Bond Indenture Constraints*

- If the project involves redevelopment of an existing facility, the bond indenture may or may not permit the release of the revenues, and if so, the release might affect the airport owner’s ability to comply with the bond rate covenant.
- The lease of site/facilities (and potential assignment of revenues) may or may not constitute a sale of airport property under the terms of the bond indenture. If so, the airport owner might not be able to satisfy the covenant necessary to make such a sale.

### *Bankruptcy*

- Does the lease underlying a special facility bond transaction have the characteristics of a true lease or disguised financing? If it appears to be a disguised financing, can the lease be amended and restructured to avoid its adverse characterization?

When contemplating a special facility financing on behalf of an airline or other party, an airport owner should be careful to ensure that the lease is a single lease that fits the parameters of a true lease (as opposed to a financing lease). As discussed in the Boston Terminal A case study (in Chapter 9), shortly after the opening of new Terminal A, Delta filed for protection under Chapter 11 of the U.S. Bankruptcy Code. To assist Delta in its reorganization efforts and to avoid the potential for costly litigation, the Massachusetts Port Authority (“Massport”), with the consent of the bond trustee and bond insurer, agreed to restructure the original lease and bond trust agreement. There was a question as to whether the lease would be deemed a true lease or disguised financing.

### *Other Considerations*

- Public–private partnerships raise questions about the role of the airport owner and what functions are most appropriate for it to perform. The questions revolve in part around who can produce a service or product more economically. A partnership would expose the airport owner to various risks—political, legal, operational, and financial. If the approach fails, the airport owner will be “politically” liable.

The early years of the lease were the most vulnerable and the Port Authority played an important role in mitigating risk in these early years. When JFKIAT fell upon hard times after September 11 and SARS, in conjunction with the accelerated debt amortization period (prior to the extension of the City Lease) and the need for completion financing, the Port Authority stepped up to assist JFKIAT by amending the lease agreement and providing subordinate financing. Although JFKIAT felt it could access financing from the bond market, the financing provided by the Port Authority provided a win-win solution for both parties as JFKIAT received relatively low priced debt at a time when its credit was rated below investment grade.

- An airport owner retains the most control over land uses occurring on property that it develops, in particular, the

ability to determine initial land uses and the flexibility to change land uses in later years in response to events or shifts in demand. Under private development, an airport owner’s control of land uses is frozen for the term of the lease unless appropriate protections are incorporated into the lease allowing it to change land uses in later years as necessary.

- An airport owner also exercises less control over uses at facilities developed by private developers, and over the quality of the appearance and maintenance of those facilities than it does over facilities it develops, unless it includes strong performance standards in the lease. The controls can also be costly to enforce.
  - The lease should provide for ongoing investments in the asset to address concerns about a developer turning back a facility at the end of a long-term lease in poor condition. For example, in the Boston Terminal A lease, Delta was required to make annual maintenance reserve payments so that funds would be set aside for facility renovation, renewal, replacement, or reconstruction, and for unusual or extraordinary maintenance or repairs. Funds in the Terminal A maintenance reserve account were available to be dispensed at the discretion of the airport owner (Massport).
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## CHAPTER 6

# Full Privatization

### 6.1 Specific Strategies

Under the full privatization models, the airport owner enters into a long-term lease/concession or sale of an airport with a private operator, which can be accomplished inside the APPP or outside of the program (Table 6.1).

Under a long-term lease or concession agreement, the airport owner grants full management and development control to the operator in return for the operator undertaking full capital improvements and other obligations (e.g., up-front payment, responsibility for outstanding debt). Under a sale, the airport is transferred on a freehold basis with the requirement that it continue to be used for airport purposes.

The use of a concession or lease has been seen as a way for governments to reassert control over assets either in the last resort or at the end of the concession lifetime. Among the benefits are:

- From the standpoint of public perception, ownership of a strategic national asset is retained. This can be a sensitive issue, particularly if foreign buyers are involved.
- The concession documentation can be a way for the airport owner to maintain control over areas which it believes to be strategic. These can include, for example, investment programs, service standards, and aeronautical and public parking pricing policies. Concession agreements can in some cases extend hundreds of pages.
- Concessions offer the opportunity for the airport owner to participate in the continuing success of the airport through rents or performance-related concession payments, which may, for example be related to turnover, profit, or traffic levels. This can have strong advantages for airports which are seen as high risk or facing major initial capital expenditure requirements.

Regarding a sale, there is a strong preference for a trade sale over an IPO on the basis of experience from international airport privatizations. Trade sales are primarily attractive

because of the higher receipts they yield to the government compared with IPOs. There are a number of reasons for this:

- The trade buyer is typically an experienced purchaser and has often gone through significant expert due diligence of the asset in a way that is not open to IPO purchasers. The risks attached to the purchase are therefore lower.
- A trade buyer is willing to pay a premium for control.
- Trade buyers can develop and implement a strategy for the company in which they are confident, and if necessary hire the required staff to implement it. Retail buyers are dependent on the company's management to develop and realize such strategies, and their confidence in the competence of the management team will impact the price they are willing to pay.
- Trade buyers have been able to apply modern financing techniques to fund their purchase, which has enhanced value.

These are more extensive transactions than airport-wide management contracts because significant airport development is anticipated. The term of the lease is related to the length of time needed by the operator to recover its investment in new facilities. A long-term lease transfers the principal responsibility for airport operations and development to the private lessee. Airport users pay fees and charges directly to the operator, with the operator taking on the risk involved in covering both operating and capital costs out of those revenues.

In addition, under the full privatization model, the airport owner transfers federal sponsorship requirements to the operator, whereas under partial privatization models the airport owner remains the sponsor.

### 6.2 Examples of Full Privatization

There are fewer examples of the long-term lease or sale of an airport in the United States than (1) partial privatization strategies and (2) international airport transactions. Below is

**Table 6.1. Full privatization strategies.**

Transaction Model	Description	Inside APPP	Outside APPP
Long-term lease	Contract by which airport is conveyed to an entity for a specified period	Limited to one large-hub airport in the U.S.	Any airport
Long-term concession	Contract to transfer rights to manage and or operate a property for a certain period, usually without property rights	Limited to one large-hub airport in the U.S.	Any airport
Trade sale	Competitive sale of an airport through a bidding process that usually results in majority control with a single entity	Limited to general aviation airports in the U.S.	Any airport
Flotation or initial public offering (IPO)	Sale of shares in the airport to individual and institutional subscribers through the stock market or other vehicle where management retains control	Never done in the U.S.	Never done in the U.S.

a brief description of examples inside and outside the APPP. For more background, please see Chapter 9 and Appendix H where two examples inside the APPP (Stewart International Airport and Chicago Midway Airport) and one example outside the APPP (Morristown Municipal Airport) are reviewed in depth as case studies.

**6.2.1 Airport Privatization Pilot Program (APPP)**

As shown in Table 6.2, there have been a number of applications for the APPP since it was created in 1996, although

the only applicant to complete the process as of March 2012 was Stewart.

**6.2.1.1 Stewart International Airport**

The first and only airport (as of August 2010) to be approved by the FAA under the APPP was Stewart International Airport in Newburgh, New York (60 miles north of New York City). National Express Group PLC, a U.K.-based transportation company, paid \$35 million for the 99-year award in 2000 (its first airport acquisition). Because the owner, the State of New York, was unable to secure airline

**Table 6.2. The Airport Privatization Pilot Program (as of March 2012).**

- Legislation allows the lease of no more than one large-hub, at least one general aviation airport (GA airport can be sold), with the balance available from non-large-hub and general aviation airports
- 65% of the airlines serving the airport must approve the exemption from prohibition of revenue diversion
- Limits increase in airline rates
- Airport can receive AIP grants and levy a PFC
- Applicants (one position remains available for a non-large-hub or general aviation airport)



*Luis Muñoz Marín International Airport, San Juan, Puerto Rico is an active participant in the APPP*

**ACTIVE** (4 out of 10 slots taken, including the only large-hub slot):

**LARGE-HUB:**

- **Chicago Midway International Airport** (final application submitted Oct 2008, pending)

**MEDIUM/SMALL HUB:**

- **Luis Muñoz Marín International Airport**, San Juan, Puerto Rico (preliminary approval Dec 2009)

**GA AIRPORT:**

- **Gwinnett County Briscoe Field Airport**, Georgia (preliminary approval May 2010)
- **Hendry County Airglades Airport**, Clewiston, Fla (preliminary approval Oct 2010)

**INACTIVE:**

- **Stewart International, Newburgh, NY** (approved 2000, reverted back to public operation 2007)
- **Brown Field/San Diego Commerce Center** (application withdrawn 2001)
- **Niagara Falls International** (application withdrawn 2001)
- **Aguadilla, Puerto Rico** (application withdrawn 2001)
- **New Orleans Lakefront** (application terminated 2008)
- **Louis Armstrong New Orleans International Airport** (application withdrawn Nov 2010)

approvals to use the payment for general state purposes (discussed in detail below), it used the lease payments for airport purposes and to recoup past subsidies for Stewart Airport and its other state-owned airports (from the prior six years) in accordance with the FAA's revenue use policy. Just as U.S. airport privatization appeared to be re-energizing, Stewart reverted back to public ownership in 2007 when National Express decided to exit the airport management business and sold its interest in the airport to the Port Authority of New York and New Jersey, the operator of the three largest commercial service airports in the New York metropolitan area.

### 6.2.1.2 Chicago Midway Airport

The City of Chicago received airline approvals for its Midway Airport pilot privatization application, but this effort is on hold due to the inability of the selected private consortium to secure financing in the aftermath of the global credit crisis of 2008. The consortium of investors led by Citigroup Inc., John Hancock Life Insurance Co., and a unit of Vancouver International Airport submitted the highest bid (\$2.5 billion) to lease Midway. When the deal fell through in early 2009, the consortium had to pay a \$126-million penalty to the city. The FAA has granted the city's request for more time to complete the deal through a series of extensions to maintain its spot (the one reserved for a large-hub airport) in the APPP. In its January 2010 filing, the city told the FAA that it "intends to complete the privatization process at the earliest practical date" but noted that "the pace and direction continues to be dictated by conditions in the global credit and capital markets." The city indicated that talks could resume with the highest bidder or other qualified bidders, or the city could put the airport out for bid again.

### 6.2.1.3 Luís Muñoz Marín International Airport, San Juan, Puerto Rico

The Puerto Rico Public-Private Partnership Authority, on behalf of the Puerto Rico Ports Authority, is actively pursuing full privatization under the APPP of the Luís Muñoz Marín International Airport in San Juan. As of December 2011, the government has received preliminary approval by the FAA to enter the program, received preliminary airline approval for the plan, issued a request for qualifications, received six qualified responses, and issued the request for proposals from the best-qualified teams. Government officials want to reduce most, if not all, of the more than \$800 million of debt the Ports Authority is carrying through a lump sum payment. The concession would be for no more than 50 years and would also require the operator to make improvements to the airport.

### 6.2.1.4 Other APPP Applicants

Regarding the inactive airport applicants, all of which withdrew their applications except Stewart, and prior to the application submitted by New Orleans International, the FAA in 2004 reported:

Several common elements to the five airports that submitted applications were: 1) management of the airport was not the owner's primary responsibility; 2) all airport facilities were underutilized airports with either limited or sporadic commercial service and serving a general aviation clientele; 3) transferring the airport from public to private ownership is time consuming; 4) all airports were operating at a financial loss and receiving some form of subsidy from their parent agencies; 5) the private operators proposed to use a limited liability corporation to manage the airport; and 6) a strong political commitment was needed to successfully transfer the airport to private control.<sup>32</sup>

The FAA also reported that the final application for Niagara Falls International Airport was withdrawn following the FAA's comment that the application no longer appeared financially viable. The selected private operator noted that its business plan was no longer valid. In addition, the rapid growth in air service at competing airports in the Buffalo and Hamilton, Ontario markets, coupled with circumstances following the terrorist attacks of September 11, 2001, created an environment that made it impossible to evaluate the airport's market potential.

The application of New Orleans Lakefront Airport was dismissed by the FAA in April 2008 in the aftermath of Hurricane Katrina and in view of the Orleans Levee District's diminished responsibility under revised State law.

The public owners of San Diego Brown Field and Rafael Hernandez Airport (Aguadilla) did not file final applications and withdrew their preliminary applications. The Puerto Rico Ports Authority (PRPA) withdrew its application for Aguadilla after going through the process to select an operator when PRPA management decided to develop the airport without the assistance of the private operator. San Diego withdrew its application in the face of community opposition to the idea of a cargo hub and its adverse impacts and an FAA air traffic impact analysis that identified potential conflicts between the proposed cargo traffic at San Diego Brown Field and traffic from surrounding airports and military bases that would have to be mitigated.

<sup>32</sup>U.S. Department of Transportation, Federal Aviation Administration, *Report to Congress on the Status of the Airport Privatization Pilot Program United States Code, Title 49, Section 47134*, August 2004.

The city of New Orleans withdrew its application for Louis Armstrong New Orleans International Airport in November 2010 citing the following reasons:

After analyzing the conditions required to effectively privatize public infrastructure and the current state of capital markets, it has been concluded that New Orleans is not well positioned at this point in time to solicit bids for privatizing the Louis Armstrong International Airport. Rather, the airport is better served by focusing on its recently announced initiatives to improve operations and become a more effective asset for the City of New Orleans and the State of Louisiana. The Louis Armstrong New Orleans International Airport is thus withdrawing from the FAA APPP.<sup>33</sup>

This review makes clear that the tumultuous first decade of the new century, which was so challenging to the airline industry, provided less than ideal conditions for the financing of airport deals under the APPP.

### 6.2.2 Outside the APPP

Morristown Municipal Airport is a general aviation airport that is owned by the Town of Morristown and has been managed and developed by DM AIRPORTS, LTD, an affiliate of the DeMatteis Organizations, since 1982 under a comprehensive 99-year lease. Although this lease did not require any special federal or state legislation (such as the APPP), it was entered into before the FAA formalized much of its policy regarding full privatization outside the APPP. The town granted DM AIRPORTS full management and development control in return for undertaking all capital improvements (many of which were needed at the time the lease was executed) and for defeasing the outstanding airport debt. DM AIRPORTS pays a relatively modest annual rent to the town to cover its cost to provide continuing police, emergency medical, and grant administration services for the airport. DM AIRPORTS retains all airport fees and charges in return for taking on the risk to cover operating expenses and capital expenditures (net of grants) out of those revenues.

It is important to note that the Morristown privatization occurred before the FAA promulgated its revenue use policy and before the creation of the APPP. Therefore, it is not reasonable to expect to be able to repeat this experience because the federal rules concerning, for example, the transfer of management responsibility and the use of rent proceeds and the private operator's compensation, are much stricter now.

## 6.3 Legal and Regulatory Considerations

### 6.3.1 General Conditions

The following legal requirements historically have influenced whether public airport operators have pursued partial or full privatization. These requirements have created opportunities for an airport owner to enlist private participation while remaining the airport sponsor (partial privatization) and simultaneously erected barriers to transferring sponsorship to a private operator (full privatization):

- *FAA approval authority*—Grant Assurance 5 requires FAA approval before the airport owner can “sell, lease, encumber or otherwise transfer or dispose of any part of its title or other interests” in the airport. The Surplus Property Act and subsequent statutes authorizing transfer of federal property for public airports contain similar requirements. In practice, FAA approval is required only for a sale or long-term lease of airport property to a public or private entity. Public airport owners can enter into management contracts, concession agreements, leases of airport facilities, and a host of other agreements with private entities without FAA approval. U.S.DOT and FAA thus act as the gate-keeper to full privatization.
- *Revenue use*—Both federal law and the grant assurances strictly limit the use of airport revenue for non-airport purposes. Airport revenue is defined broadly to include the proceeds from the sale or lease of airport property. There are some narrow exceptions, such as for so-called “grandfathered” airports and for repayment of loans issued by sponsoring governments. However, Congress has expressed serious concern with revenue diversion and has prescribed onerous penalties for violations. The prohibition on revenue diversion applies only to the airport sponsor, not the air carriers, FBOs, concessions, private airport managers, or any other private entities that conduct business on an airport. This has incentivized private ventures on airports but has dis-incentivized full privatization. It historically presented a particularly high barrier to full privatization because, outside the APPP, the public airport owner is required to use the sale proceeds for airport purposes and because the private operator, upon assuming responsibility for the grant assurances, must use revenue that it generates in connection with the airport for airport purposes.
- *Grant eligibility*—Under the AIP, public entities are eligible to receive an apportionment from the Entitlement Fund and to receive grants from the Discretionary Fund. In contrast, private entities are not eligible to receive an apportionment, and only private operators of certain types of airports are eligible for certain types of discretionary grants.

<sup>33</sup>Louis Armstrong New Orleans International Airport Withdraws from FAA Airport Privatization Pilot Program, New Orleans Aviation Board Press Release, October 21, 2010.

Specifically, public-use airports operated by a private entity that are designated as relievers or that have at least 2,500 annual passenger boardings are eligible for funding for airport development projects, airport master planning, noise compatibility planning, and noise program implementation projects. This financing structure historically dis-incentivized full privatization because it encouraged public entities to retain the role of sponsor, and thus eligibility for funding under the AIP.

- *Grant repayment*—Another historical barrier to full privatization was the uncertainty as to whether or not a public airport owner would be required to repay the federal government upon sale or long-term lease to a private operator, for the value of land acquired from the federal government under the Surplus Property Act, for the value of land acquired with federal financial assistance, or for the value of grant-funded capital improvements and equipment. The relevant statutes clearly require reinvestment or repayment in the event the property is sold for a non-airport use; however, the statutes are ambiguous as to whether the reinvestment or repayment obligation is triggered by transfer of the airport to a private operator for continued use as a public airport. This uncertainty historically dis-incentivized full privatization because of the potential financial liability associated with privatization.
- *Non-aeronautical activities*—Airport owners have considerably greater latitude over non-aeronautical activities than aeronautical activities. For example, airport owners must charge a minimum of fair market value for non-aeronautical use, but can charge higher amounts for rent and other fees, subject to Constitutional standards. Similarly, airport owners are not subject to the prohibition on granting exclusive rights with respect to non-aeronautical users of an airport. While public airport operators theoretically are subject to suit under the anti-trust statutes, many courts have found that public entities are immune from liability for certain anti-competitive behavior. Private entities would not enjoy similar immunity. The greater control and flexibility over non-aeronautical activities presents the opportunity for a private operator to generate a return on its investment by maximizing non-aeronautical revenues to the greatest extent permitted by the market. This opportunity comes with some liability exposure to the private operator. As to partial privatization, airport operators can enlist private participation in non-aeronautical activities through, for example, master concession agreements and similar vehicles, to give private enterprise a significant role in non-aeronautical activities.
- *Constitutional Rights and Protections*—State and local governments acting as airport operators must not deprive airport tenants and users of the rights and protections afforded by the U.S. Constitution. These rights and protections

include, for example, freedom of speech and the press under the First and Fourteenth Amendments,<sup>34</sup> and equal protection and due process rights under the Fifth and Fourteenth Amendments. While private parties typically are *not* responsible for guaranteeing Constitutional rights and protections, courts have applied the Constitution to private actors providing a “public function”<sup>35</sup> or where the private action is “entwined” or “entangled”<sup>36</sup> with state action. One court has held that a private entity operating an airport pursuant to a lease with the public airport owner is responsible for ensuring Constitutional protections.<sup>37</sup> However, the extent to which private airport operators engaged in the range of activities described herein as full and partial privatization would be deemed state actors responsible for guaranteeing Constitutional rights and protections is uncertain.

- *Property Taxes*—Public airport operators enjoy exemptions from property taxation pursuant to the constitution and/or laws of most states. These exemptions typically would not apply to a private operator of a public-use airport. This tax structure dis-incentivizes full privatization, at least any transfer that would jeopardize the airport’s eligibility for an exemption.

### 6.3.2 The Airport Privatization Pilot Program (APPP)

The APPP, as enacted in 1996 and amended in 2003 and 2012, reduced uncertainty about the privatization process and addressed the recognized barriers to privatization by

<sup>34</sup>The U.S. Supreme Court has declared that airport terminals are non-public fora, meaning that speech may be subject to reasonable government regulation.

<sup>35</sup>*Lebron v. Nat’l R.R. Passenger Corp.*, 513 U.S. 374, 115 S.Ct. 961, 130 L.Ed.2d 902 (1995); *West v. Atkins*, 487 U.S. 42 (1988) (private physician employed part-time by a state prison hospital); *Lugar v. Edmondson Oil Co.*, 457 U.S. 922 (1982) (private seizure of property executed under a state garnishment statute); *Terry v. Adams*, 345 U.S. 461 (1953) (privately-run public elections); *Marsh v. Alabama*, 326 U.S. 501 (1946) (conduct on public streets in a company town); *but see Blum v. Yaretsky*, 457 U.S. 991 (1982) (private nursing home receiving government funds), *Rendell-Baker v. Kohn*, 457 U.S. 830 (1982) (private, remedial high school receiving government funds); *Moose Lodge No. 107 v. Irvis*, 407 U.S. 163 (1972) (private club with a state-issued liquor license).

<sup>36</sup>*Brentwood Acad. v. Tenn. Secondary Schools Athletic Ass’n*, 531 U.S. 288 (2001) (private athletic association 84% of whose members are public schools); *Evans v. Newton*, 382 U.S. 296 (1966) (public park created by private will, but maintained and supervised by a municipality); *Pennsylvania v. Bd. of Dirs. of City Trusts of Philadelphia*, 353 U.S. 230 (1957) (private school operated by a state agency); *but see Nat’l Collegiate Athletic Ass’n v. Tarkanian*, 488 U.S. 179 (1988) (national athletic association with members from many states not a “state actor” with respect to Nevada law).

<sup>37</sup>*Niswonger v. Am. Aviation, Inc.*, 424 F. Supp 1080 (D. Tenn. 1976).



permitting U.S.DOT to grant exemptions from certain federal obligations that historically impeded full privatization.<sup>38</sup> However, Congress required that airports and private operators satisfy demanding conditions in exchange for the exemptions and approvals, including conditions specifically designed to protect its interests and those of the airport users. The FAA thereafter prescribed detailed procedures for seeking these exemptions and approvals. Viewed as a whole, the APPP today is complex, demanding, and lengthy. This is in part because full privatization transactions are more complicated in general, but also due to the specific legislative requirements imposed by the APPP.

The federal law creating the APPP prescribes the following requirements:

1. A general aviation airport may be sold or leased. A commercial service airport may be leased only.<sup>39</sup>
2. Ten airports may receive approval to privatize under the APPP.<sup>40</sup> One of the 10 airports must be a general aviation airport.<sup>41</sup> No more than one airport may be a large-hub primary airport.<sup>42</sup>
3. The Secretary may permit the public airport owner to use sale or lease proceeds for non-airport purposes upon approval (i) in the case of a primary airport, by at least 65% of the scheduled air carriers and by scheduled and unscheduled air carriers accounting for 65% of aircraft landed weight at the airport, and (ii) in the case of a nonprimary airport, by the Secretary after the airport has consulted with at least 65% of the owners of aircraft based at the airport.<sup>43</sup>

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<sup>38</sup>As noted in an earlier report: “. . . 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 . . . 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.” Source: General Accountability Office, *Airport Privatization, Issues Related to Sale or Lease of Airports*, November 1996, GAO/RCED-97-3.

<sup>39</sup>49 U.S.C. § 47134(a).

<sup>40</sup>*Id.* § 47134(b). In the initial version of the APPP adopted in 1996, the number of airports was limited to five. It was increased to 10 by the FAA Modernization and Reform Act of 2012, Pub. Law No. 112-95, § 156 (2012).

<sup>41</sup>*Id.* § 47134(d)(1).

<sup>42</sup>*Id.* § 47134(d)(2).

<sup>43</sup>*Id.* § 47134(b)(1)(A).

<sup>44</sup>*Id.* § 47134(b)(2).

4. The Secretary may exempt the public airport owner from any legal requirement to repay prior grants or return airport property to the federal government.<sup>44</sup>
5. The Secretary may permit the private operator to use airport revenue for non-airport purposes in order to “earn compensation from the operations of the airport.”<sup>45</sup>
6. The statute requires that the following nine conditions must be satisfied to obtain approval:
  - a. The airport will continue to be available for public use on reasonable terms and without unjust discrimination.
  - b. The airport will continue to operate in the event the private operator becomes insolvent, seeks bankruptcy protection, or under similar circumstances.
  - c. The private operator will maintain, improve, and modernize the airport in accordance with plans submitted to the Secretary.
  - d. Rates and charges on air carriers will not increase faster than the rate of inflation unless a faster increase is approved by at least 65% of the air carriers serving the airport and by air carriers accounting for at least 65% of aircraft landed weight at the airport.
  - e. The fees on general aviation aircraft will not increase faster than the rate of increase for air carriers.
  - f. Safety and security at the airport will be maintained at the highest possible levels.
  - g. Noise effects will be mitigated to the same extent as at a public airport.
  - h. Adverse environmental effects will be mitigated to the same extent as at a public airport.
  - i. The sale or lease will not abrogate any collective bargaining agreement covering airport employees.<sup>46</sup>
7. The Secretary must conclude expressly that approving the sale or lease will not result in unfair and deceptive practices or unfair methods of competition.<sup>47</sup>
8. The Secretary must ensure that the interests of general aviation users at the airport are not adversely affected by the sale or lease.<sup>48</sup>
9. The private operator will be eligible to impose a Passenger Facility Charge.<sup>49</sup>
10. The airport will be eligible to receive an apportionment from the Entitlement Fund.<sup>50</sup>
11. The private operator may impose “reasonable rental charges, landing fees, and other service charges from aircraft operators” consistent with the Anti-Head Tax Act.<sup>51</sup>

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<sup>45</sup>*Id.* § 47134(b)(3).

<sup>46</sup>*Id.* § 47134(c).

<sup>47</sup>*Id.* § 47134(e).

<sup>48</sup>*Id.* § 47134(f).

<sup>49</sup>*Id.* § 47134(g)(1).

<sup>50</sup>*Id.* § 47134(g)(2).

<sup>51</sup>*Id.* § 47134(g)(3).

12. The federal share of financial assistance in grants issued from the Discretionary Fund issued to a private operator is 70% of project costs.<sup>52</sup>

In September 1997, the FAA published detailed procedures for the submission and review of applications to sell or lease an airport in accordance with Section 47134.<sup>53</sup> The application procedures have the key features shown in Figure 6.1.

*Note on Foreign Investment*—In addition to the FAA application procedures, it is possible that the sale or lease of an airport to a private operator that is a foreign entity may be subject to investigation by the Committee on Foreign Investment in the United States (CFIUS).<sup>54</sup> An investigation may be initiated by the President, by the CFIUS, or based on voluntary notice of the intended transaction to the CFIUS. The President can prohibit the transfer upon finding that the foreign interest threatens to impair national security. Alternatively, the CFIUS can impose conditions to mitigate an identified threat. The CFIUS is concerned principally with transactions by which a U.S. business would become controlled directly or indirectly by a foreign government. In 2006, the sale of port management businesses in six major U.S. seaports to a state-owned company based in the United Arab Emirates (DP World), created a controversy when political figures in the United States feared the sale would compromise U.S. port security, even though the sale was approved by the CFIUS. After both the U.S. House and Senate took actions to block the sale, DP World sold the U.S. ports to a U.S. asset management company, ending the controversy.

### 6.3.3 Full Privatization Outside the APPP

Since 1996, no public airport operator has sought to sell or lease an airport to a private operator outside of the APPP. However, this option remains available, and may be pursued in the event that either all the available slots in the APPP program are encumbered, or if an owner chooses to privatize outside the regulatory boundaries of the APPP. The FAA has not published guidance specifically on this subject; however,

<sup>52</sup>*Id.* § 47109(a). In the initial version of the APPP adopted in 1996, the federal share was 40%. It was increased to 70% by *Vision 100—Century of Aviation Reauthorization Act of 2003*, Pub. Law No. 108-176, § 163 (2003).

<sup>53</sup>FAA, *Notice of Final Application Procedures, Airport Privatization Pilot Program: Application Procedures*, 62 Fed. Reg. 48693 (1997).

<sup>54</sup>See 50 U.S.C. § 2170. See also Dept. of Treasury, *Final Rule, Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons*, 73 Fed. Reg. 70716 (2008); Dept. of Treasury, *Notice, Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States*, 73 Fed. Reg. 74567 (2008).

the FAA provided some guidelines in the *Airport Compliance Manual*, released in September 2009.<sup>55</sup>

Privatizing outside the APPP has the following attributes:

1. FAA approval is required to transfer the grant assurances from the public owner to the private operator and may be required for other purposes.
2. The FAA will review a request to transfer an airport to a private operator in a similar fashion to its review of a request to transfer an airport to another public entity.
3. The FAA may require the public airport operator to maintain concurrent responsibility for certain grant assurances, such as the obligations concerning compatible land use and hazards to air navigation.
4. The FAA will not approve an application without a commitment by the private operator to assume responsibility for the grant assurances and any Surplus Property Act deed restrictions.
5. The FAA will not exempt the public airport operator from the prohibition on revenue diversion, but may permit the private operator to recover its initial investment and receive compensation for managing the airport.
6. The FAA will not require repayment for the value of grant-funded projects and land transferred by the federal government according to FAA Order 5190.6B.
7. The private operator will not be eligible for an apportionment from the Entitlement Fund.
8. The private operator will be required to obtain a separate Airport Operating Certificate and to prepare an Airport Security Program.
9. The private operator could impose a charge on passengers, but could not require the airlines to collect a PFC.

Table 6.3 compares the key features of full privatization under the APPP and outside the APPP.

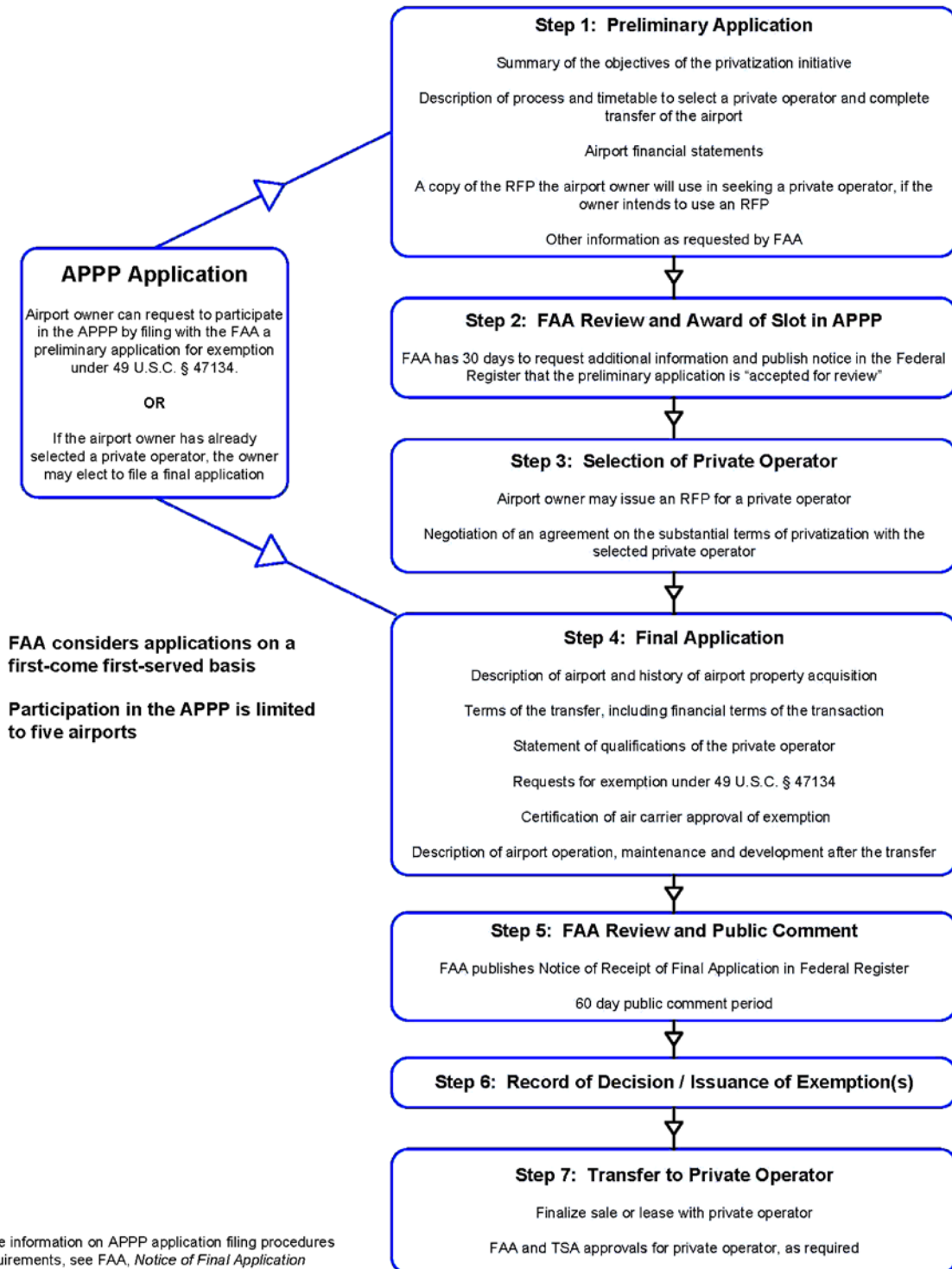
## 6.4 Evaluation of Full Privatization

The most comprehensive research on the effect of privatization, corporatization, and ownership forms on airport performance concluded there is strong evidence that:

- Airports with government majority ownership and those owned by multi-levels of government are significantly less efficient than airports with a private majority ownership;
- There is no statistically significant evidence to suggest that airports owned and operated by U.S. government branches,

<sup>55</sup>FAA Order 5190.6B, *Airport Compliance Manual*, § 6.15 (Privatization Outside of the Airport Privatization Pilot Program) (Sept. 2009).

## Airport Privatization Pilot Program Application Procedures



For more information on APPP application filing procedures and requirements, see FAA, *Notice of Final Application Procedures, Airport Privatization Pilot Program: Application Procedures*, 62 Fed. Reg. 48693 (1997).

**Figure 6.1. APPP application procedures.**

**Table 6.3. Key features of full privatization under the APPP and outside the APPP.**

	<b>Full Privatization Pursuant to Pilot Program (49 USC § 47134)</b>	<b>Full Privatization Outside Pilot Program (per FAA Order 5190.6B)</b>
Eligible Airports	No more than five airports eligible to participate. Only one slot currently available.	No cap on number or type of airports.
Lease or Sale	Commercial service airports can be leased, but <u>not</u> sold. General Aviation airports can be leased or sold.	Airport can be leased or sold.
Airport Sponsorship and Grant Assurances	Private operator becomes airport sponsor, subject to Grant Assurances. The FAA may require public airport owner to remain responsible for certain Assurances.	Private operator becomes airport sponsor, subject to Grant Assurances. The FAA may require public airport owner to remain responsible for certain Assurances.
FAA Approval	FAA approval required under the APPP statute.	FAA approval required, primarily to transfer the Grant Assurances to the private operator, and to approve a new Airport Operating Certificate, if applicable.
Application Process	The FAA has developed application process specifically for the APPP.	Subject to the application requirements for transfer or release of Grant Assurances, currently set forth in FAA Order 5190.6B.
Use of Sale Proceeds	Public airport owner can request FAA approval to use sale proceeds for non-airport purposes. For primary airports, requires consent of 65% of airlines. For nonprimary airports, requires consultation with 65% of based aircraft owners.	Sale proceeds must be used for airport purposes.
Use of Revenue by Private Operator	The FAA is authorized to permit private operator to earn compensation from airport operations.	Private operator generally subject to the prohibition on revenue diversion. FAA may recognize right to recover initial investment and receive reasonable compensation for managing airport.
Grant Repayment	The FAA <u>may</u> excuse public airport sponsor from any repayment obligation that may exist.	The FAA <u>will</u> excuse public airport sponsor from any repayment obligation that may exist.
AIP – Entitlement	Private operator is eligible for grants from the Entitlement Fund.	Private operator is <u>not</u> eligible for grants from the Entitlement Fund.
AIP – Discretionary	Private operator at certain types of airports may be eligible for grants from Discretionary Fund. If eligible, federal share will be limited to 70% of project cost.	Private operator at certain types of airports may be eligible for grants from Discretionary Fund. If eligible, federal share will be 75% or 90%, depending on NPIAS status of airport.
Rates and Charges	Rates on airlines may not exceed inflation rate without consent of 65% of airlines. Rates on aircraft owners may not exceed percentage rate increase on airlines.	Rates and charges must be reasonable and not unjustly discriminatory, pursuant to Grant Assurances.
Private Operator's Charges on Passengers	Private operator is authorized to impose, collect and use a Passenger Facility Charge.	Private operator not authorized to impose a PFC but is authorized to impose charges on passengers, subject to reasonableness and non-discrimination requirements of the Grant Assurances.

- independent airport authorities in North America, or airports elsewhere operated by 100% government corporations have lower operating efficiency than airports with a private majority ownership;
- Airports with a private majority ownership achieve significantly higher operating profit margins than other airports;
  - Whereas airports with government majority ownership or multi-level government ownership have the lowest operating profit margin; and
  - Airports with private majority ownership derive a much higher proportion of their total revenue from non-aviation services than any other category of airports with significantly

lower aeronautical charges than airports in other ownership categories excluding U.S. airports.<sup>56</sup>

### 6.4.1 Opportunities

Some of the opportunities cited for full privatization include:

- Creates potential to promote increase in service, commerce, and economic development.

Policy makers recognize that airports are strategic assets and have the potential to deliver long-term value to the local economy. Some policy makers see airport privatization as an economic development strategy. For example, David Alvarez, executive director of the Puerto Rico Public-Private Partnerships Authority, believes that the privatization of San Juan's Luis Munoz Marin Airport is, "More than a transaction, it is an economic development measure for Puerto Rico."<sup>57</sup> He also believes that the private sector can do a better job than the public sector managing airports.

- Secures a lump sum or ongoing lease payments by selling or leasing airport for budgetary relief (asset monetization) or for annual payments to government owner.

One of the primary motivations for airport privatization from policy makers may be to derive cash proceeds from the sale or long-term lease of the airport either through an up-front payment or annual payments. However, diverting airport lease or sale proceeds is prohibited under federal law without airline approval, and this can only be accomplished under the APPP. Often there is tension between the desire for money from the lease and not wanting to turn over a public asset to the private sector.

The financial situation for municipalities is expected to get worse as they run out of ways to raise funds for pensions, capital improvements, and ongoing operations. Therefore, the potential for a cash-out payment (under the APPP) may be attractive to politicians that do not currently receive financial benefits from airports because of the prohibition on revenue diversion.

- Obtains private capital investment for capacity expansion and modernization and reduces need for public investment and debt. A confluence of factors may force U.S. airport owners to explore privatization in the not-too-distant future, including the potential loss of tax-exempt

financing, real reductions in AIP funding, and no increase in the PFC level.

- Has the potential to increase the operating efficiency of existing facilities.
- Has the potential to introduce technological and management expertise.
- Has the potential to allow for more commercialization and potential for a more business-like management philosophy for the airport.

As the largest and most important tenant for commercial service airports, airlines in the United States are still skeptical about full privatization, but can see some benefits if it is "done right and well." The key concerns for U.S. airlines are reasonable rates and charges, maintenance of the facilities, and sufficient (but not excessive) facilities. They believe that some airports are better candidates than others for full privatization. They believe the "practicality for privatization" depends on the factual circumstances for the airport. For example:

- Higher debt airports are less appealing candidates for privatization because the higher the debt, the higher the premium needed to pay off the debt and still realize a meaningful residual payment for the government. Moreover, the airport debt is likely to be tax-exempt while the private entity would need to replace that debt with more costly taxable debt.
- Well run airports are not good candidates for privatization because it will be more difficult to extract cost efficiencies and uncover revenue opportunities from the future operation of the airport.
- Airports that have problems with governance and lack operational independence might be better run under alternative structures such as privatization. There could be significant efficiencies gained if the airport is shielded from political influence.

### 6.4.2 Advantages

Advantages cited regarding full privatization include:

- Allows airport to be developed, managed, and operated as a business. However, it should be noted that U.S. airport managers believe that as a number of airports have transitioned from residual to compensatory ratemaking, public airport managers have been motivated to operate their airports more efficiently and be more entrepreneurial.

U.S. airport managers also feel that they can do as good a job, if not better, than private operators if they were unburdened by cumbersome, rigid regulations and processes such as civil service hiring and construction bidding requirements. Nevertheless, some airport managers

<sup>56</sup>Tae H. Oum, Nicole Adler, Chunyuan Yu, *Privatization, corporatization, ownership forms and their effects on the performance of the world's major airports*, Journal of Air Transport Management, November 2006.

<sup>57</sup>David Alvarez, Puerto Rico Airport PPP Update & Perspectives, Bond Buyer Transportation Finance/P3 Conference, November 10, 2010.

expressed frustration with the lack of speed when undertaking public projects and the inherent problems associated with the many local requirements to accept the lowest bid. With a PPP, the government can avoid the low bid, move faster, get better quality control, and still meet disadvantaged business enterprise (DBE) goals.

- Provides ability for the private sector to innovate, introduce operational efficiencies, and create new income streams. The areas with most potential for private operators are (1) operating efficiencies, by maximizing the utilization of existing facilities and incentivizing employees, and (2) maximizing non-aeronautical revenues.
  - Regarding the utilization of existing facilities, one operator has realized 30% to 40% savings in terminal space requirements by strategically positioning new technology such as common use self-service kiosks at key points (parking lots, rental car return areas) to move passengers more efficiently and minimize the amount of ticket queue space needed.
  - In terms of non-aeronautical revenues, by making the security screening process more efficient, passengers have more time to spend post security and are more relaxed. In addition, private operators tailor concession programs to the airport's demographics and actively manage these programs.
  - Private operators have more flexibility to incentivize employees (e.g., bonuses, succession programs, and training), can use employees for a wider range of disciplines, and are not burdened by public processes. They note that public ownership imposes significant costs on the system especially through procurement rules (e.g., local business enterprise goals, consultant selection, concession awards) and rigid personnel systems.
- De-politicizes airport operations and insulates airport from broader public policies.
- Provides flexibility to structure and tailor debt to meet infrastructure needs, including potential to tap foreign markets for financing.

### 6.4.3 Disadvantages

Disadvantages cited regarding full privatization include:

- Involves significant time, effort, and out-of-pocket expense to undertake (for both the public and private sector). Therefore, an airport owner seeking to privatize its airport(s) needs to give careful consideration to the design of the privatization transaction process. Failure to meet the requirements of potential investors could lead to a lack of willingness on the part of investors to participate in the bidding process.
- Involves loss of control by policy makers such as long-term policy decisions, influencing the award of contracts, and

hiring decisions. Losing control over airport assets can be a vexing decision for policy makers. In addition, there is not always consensus among policy makers on the merits of privatizing their airport.

- Requires multiple layers of approvals (federal, state, local, tenants, and employees).
- Can be constrained by existence of airline use and lease agreements.
- Involves limitations on aeronautical rate increases and requires airline approval to take money out of the aviation system, which can be difficult to obtain and can reduce the value of the transaction. The airlines often also ask for capital investment commitments.

Some U.S. airport managers feel that the requirement for 65% airline approval puts the airlines back in control of airports because their approval is needed for the airport owner to monetize the airport. Private airport operators feel that the APPP is an “utter failure.” For example, the unusually restrictive rules under the APPP give airlines an “effective veto” over privatization. Moreover, they expressed concern that the airlines got a “sweetheart deal” at Midway, which will serve as the baseline for all future privatization transactions.

On the other hand, some airlines see merits in the idea of stable and predictable landing fees and rental rates that could come under privatized airports. In fact, as a result of the concessions made in the proposed Midway transaction, the airlines have started to be more receptive to potential long-term leases. It was important to Southwest Airlines that the Midway deal included price caps and operating standards. The operator lease included extensive performance standards that were negotiated with the city and Southwest. Southwest also required guarantees that the airport would be run in a customer service friendly fashion, with a particular focus on pricing controls—to the greatest extent possible—with respect to parking, concessions, etc. Southwest wanted to make sure that concessions and parking rates, in particular, were competitive with those at Chicago O’Hare so that use of Midway by passengers was not cost-prohibitive. The Midway lease also required that the operator continue to make capital expenditures to maintain and develop the airport, which was an important factor for the airlines.

However, some airlines expressed skepticism on whether the selected Midway operator could have made the Midway deal work and concern that the deal might have been renegotiated if the operator was failing.

Given the long-term nature of the leases, airlines are concerned about controlling their costs at airports in the future. They will endeavor to do this through negotiated price caps and escalators, and/or through some form of participation in the concession agreement.

- Tempts elected officials to want to cash-out value (“borrow against the future”) without necessarily appreciating and understanding the long-term implications to the airport enterprise. For example, many U.S. airport managers believe that the Midway transaction was proposed almost entirely for the upfront payment. They believe it was not pursued because of the lack of competence of its management team or the inability to finance airport improvements. Airport managers were concerned about the longer term implications of the transaction on the ability for Midway to serve the needs of the community.

The airlines noted that it is important to align the interests of the parties (airport owner, private operator, and airlines) more closely. Rather than a large upfront payment, they think it might be better to structure the transaction with annual payments whereby all parties benefit if the airport grows. They reason that a large upfront payment does not motivate the airport owner beyond the transaction date and leaves all the risk to the operator and airlines. This in turn motivates the airlines to negotiate a cap on rate increases to mitigate their risk in the transaction.

- Involves higher financing costs (for private capital) than public tax-exempt debt.

Usually full privatization transactions are financed by a mix of equity, bank debt, and bond debt. Although private operators can optimize the capital structure in a prudent manner, they universally agree that the tax-favored status in the United States (which was cited as worth as much or more than 200 basis points) is a significant deterrent to full privatization. In addition, bank loans have shorter amortization periods than tax-exempt bonds, which increases the refinancing risk. Therefore, it is vital to time capital expenditures correctly and not overbuild facilities.

Lenders (banks) have become more selective when it comes to identifying investment opportunities. They tend to focus on (1) leverage, senior lien, and refinancing risk, (2) cash flow stability, and (3) security (i.e., in the case of default, lenders need recourse to assets to offset the debt).

Investors (private equity funds, infrastructure funds, and pension funds) are concerned about risk and return, control, and transaction process. Investors determine the rate of return that they will require in exchange for exposure to these risks, which tends to vary among the three categories of investors.

Regarding equity, the airlines are concerned that private entities need to earn a return on their investment in addition to higher borrowing costs from their lack of access to tax-exempt debt and grants (outside the APPP). As interest rates increase in the future, the spread between taxable and tax-exempt debt will likely increase. They are concerned that savings from more efficient operations and enhanced non-aeronautical revenues may not be large enough to

recover the operator’s higher cost of capital except at airports that are run inefficiently and/or have high social policies.

However, private airport operators were dismissive of those who cite privatization as likely to lead to increased costs to air carriers. They believe it is in the interest of the airline and the private operator to keep costs low. Also, under federal regulations, aeronautical rates are subject to the reasonableness and unjust discrimination standards imposed by the grant assurances. In fact, around the world, private airport operators face a variety of national regulations covering aeronautical rate-setting (e.g., approval by regulators, standards legislated consistent with International Civil Aviation Organization (ICAO) principles, and airport-airline dispute resolution mechanisms) and they still manage to earn a profit.

Private airport operators were also dismissive of claims that they cannot compensate for their profits through cost reductions. They believe they can realize significant savings over public airport operators by not being bound by public procurement and management procedures. Part of those savings can be used to hire more qualified staff, even if they have to pay their staff more. The operators invest in highly qualified people and use their expertise to drive down the costs to operate the airport while keeping capital expenditures in check.

- Could involve buyouts and compensation for existing public workers.

Labor will strongly oppose any privatization measures that abrogate union contracts, contract out existing airport employees’ work, or reduce wages and benefits. Under the APPP, airport owners are not permitted to abrogate collective bargaining agreements covering airport employees.

In the Midway transaction, the city of Chicago secured the support of unions by ensuring that current employees would be offered jobs with similar pay and benefits in the lease with the operator or in another department within the city. The city’s commitment to use the lease proceeds to fund pensions and city infrastructure also helped win union support for the transaction.

In the Stewart transaction, the state required the operator to retain the State Troopers for airport security protection to avoid labor issues. In Midway and Morristown, the cities retained the responsibility for providing police and fire protection.

- Can involve implementation risk in the event the bidder desires to get out of the transaction. As shown in the Stewart case study, the airport owner reserved the right to approve any assignment of the lease and prohibited the operator from selling the lease for a period of five years.
- Can involve loss of control of the airport by the airport owner. However, the airport owner can include performance

standards in the lease, which can be fixed for the duration of the long-term contract.

- Affords limited opportunities because many of the largest U.S. airports already operate like commercial enterprises and few of the smaller airports have strong commercial potential.

As noted earlier, the airlines contend that some airports are better candidates than others for full privatization. They believe the “practicality for privatization” depends on the factual circumstances for the airport.

- May result in a renegotiation of the contract due to changing market conditions, which are next to impossible to foresee, because of the long-term nature of these leases (50–99 years).
- Creates long-term risk and responsibility for the airport owner to continue to oversee the performance of the privatized operator and may also require the airport owner to be ready to operate the airport, if needed, in the event of default or bankruptcy.
- Can expose the airport owner to political, legal, operational, and financial risk if the transaction is not consummated or if the private entity incurs financial difficulties.
- Uncertain effects on tort liability for acts of terrorism, aircraft accidents, etc., particularly since the private operator would not likely be entitled to the same sovereign legal immunities as a public entity.
- Runs the risk that tenants and users may perceive pricing to be unfair because the private operator will likely offer market pricing even though aeronautical charges will be subject to fee reasonableness requirements and under the APPP to air carrier consent for fee increases greater than inflation. If tenants and users are accustomed to low and subsidized costs they may not respond well to market prices, particularly if they are not introduced in an incremental manner.
- Presents potential for controversy in the event of foreign ownership. In addition, it is possible that the sale or lease of an airport to a private operator that is a foreign entity may be subject to investigation by the CFIUS. For example, the sale of port management businesses in six major U.S. seaports to a state-owned company based in the United Arab Emirates (DP World) in 2006, created a controversy by political figures in the United States who feared the sale would compromise U.S. port security even though the sale was approved by the CFIUS.
- Gives airport owner less control over customer service standards and airport pricing although performance standards can and should be included in the lease.

For example, passengers are primarily concerned with the prices and the quality of service. Prices include airline fares, purchases from airport concessions (e.g., food/beverage, merchandise, services), and the cost to use airport facilities such as parking, rental cars, taxis, WiFi, etc. For example, if

airline costs increase as a result of a change in operation, the airlines could increase their ticket prices and/or cut back or eliminate flights in response.

On the other hand, private airport operators believe consumer concerns about increased parking rates and concession pricing are a fallacy. Private developers have demonstrated a serious commitment to street pricing as being integral to their business model (e.g. Westfield, Marketplace, and AIRMALL® at their U.S. concession operations). They believe private operators need to be competitive with off-airport parking lots and other modes of transportation, and through better management, their prices do not have to be higher to achieve more net revenue.

In addition, as noted above, performance standards can and should be included in the lease.

- May involve less consideration of local policy issues, environmental impacts, and community interests in favor of shareholder and investor interests. Unlike private entities, public entities do not report to shareholders and are bound to a different bottom-line.
- May receive less local support if the public owner cannot take money out of the aviation system.
- Provides less access to federal grants.

#### 6.4.4 Complexity, Risk, and Other Implementation Issues

Entering into a long-term lease or sale involves the most complexity and risk for an airport owner as demonstrated in the Chicago Midway transaction where the city spent over three years and roughly \$13 million for costs associated with the privatization process only for the transaction to fail due to the collapse of the debt and equity markets. (The city received a \$126 million breakup fee from the winning bidder and was able to reimburse itself for all its out-of-pocket expenses and still have \$113 million left over for other general fund uses because the fee was considered to be liquidated damages and not airport revenue.)

As noted in the Midway case study, going through the APPP can be a lengthy, complex, time-consuming, and expensive process. The rewards could be big, but success is not guaranteed. Full airport privatization in the United States is far more complicated than privatizing toll roads or parking facilities given the highly regulated environment, a more diversified mix of revenue generating assets, complexities involved in operating an airport, the pace of technological changes affecting airports, and the multiple approvals needed, including:

- FAA (for various approvals)
- TSA (for the airport security plan)
- CFIUS (if CFIUS regulations apply in the context of the sale or lease of the airport to a private operator that is a foreign entity)



- Labor (in particular collective bargaining agreements)
- Airlines (if revenue is to be used for non-airport purposes)
- Local requirements (e.g., city council)
- State legislation (if existing state law would preclude the transaction and/or if seeking exemption from property taxes)

Therefore, it is important to estimate the expected net proceeds early in the process to know if the transaction can yield positive benefits.

Other issues involved in transferring the control of an airport (by lease or sale) to the private sector include:

- Ensuring that the public interest in the airport and its services is protected.
- Ensuring that private sector returns do not overly burden user non-aeronautical fees.<sup>58</sup> Indeed, privatization generates concerns about profit-taking from an asset that is traditionally viewed as a nonprofit governmental function.<sup>59</sup>

Successful implementation of full privatization models also requires that there be a committed political leader to champion it.<sup>60</sup>

Bankruptcy also is an important consideration. In evaluating the opportunities for and barriers to airport privatization prior to the APPP, the U.S. General Accounting Office found that the Bankruptcy Code may limit a local government's ability to terminate a lease or management contract or substitute a new operator in the event of bankruptcy, and also may enable the private operator under bankruptcy protection to reject the lease or management agreement.<sup>61</sup>

Congress partly addressed this risk by requiring, as a condition of approval under the APPP, that the applicant demonstrate that airport operations would not be interrupted in the event that the private operator seeks bankruptcy protection.<sup>62</sup> Applicants have argued, and FAA has accepted, that, as a measure of last resort, the public entity could retake possession of the airport in the exercise of its police or regulatory

powers.<sup>63</sup> This is because, while the filing of a petition under the Bankruptcy Code triggers an automatic stay of most judicial and administrative proceedings, certain actions in furtherance of a public entity's police and regulatory power are not subject to this bar.<sup>64</sup>

As a legal and practical matter, the sale, lease or concession agreement explicitly will address remedies in the event of bankruptcy. As reflected in examples of privatized assets other than airports, it may be the case that a private operator is fully capable of continuing to operate the facility while in the process of reorganization under the Bankruptcy Code. Nevertheless, bankruptcy plainly adds complexity and some measure of risk to the long-term lease or sale of an airport.

It is also more difficult to offer tax-exempt financing to bidders for long-term leases, which is a way to substantially lower the amount of financing needed by private investors (as frequently employed in developer financings). This is because in order to qualify for the federal tax exemption, the asset must be governmentally owned, which means the term of the lease cannot be greater than 80% of the useful life of the asset. In addition, under IRS regulations, tax-exempt bonds cannot be used to acquire existing assets unless at least 15% of the proceeds are used for rehabilitation expenditures for buildings associated with the property.<sup>65</sup>

As noted earlier, direct and indirect federal controls dramatically affect the incentives and opportunities for privatizing public-use airports. For example:

- The sale or lease of an airport to a private operator, within or outside of the APPP, requires FAA approval.
- For privatization outside the APPP, the FAA requires that private operators agree to assume responsibility for the grant assurances, Surplus Property Act deed restrictions, and other federal obligations. The FAA has not indicated what other conditions might apply to privatization outside of the APPP.
- For privatization within or outside the APPP, the private operator will be responsible for compliance with the grant assurances, at least for so long as the grant assurances might otherwise remain applicable. Also, the FAA may require that the public airport operator in either circumstance concurrently maintain responsibility for certain grant assurances.
- In 2009, the FAA clarified that public airport operators privatizing outside the APPP will not have to reinvest or repay prior federal grants so long as the airport continues to be made available for public use.

<sup>58</sup>Regarding aeronautical user fees under the APPP, statutory provisions, grant assurances, and the FAA's Record of Decision would govern the return on investment permitted by the airport operator. Outside the APPP, grant assurances govern the reasonableness of airport-airline fees.

<sup>59</sup>Laurence E. Gesell, Ph.D., A.A.E. Arizona State University, *Airport Privatization and the Reluctance of U.S. Airports to Adapt*, September 15, 2007.

<sup>60</sup>GAO, *Privatization: Lessons Learned by State and Local Governments*, GAO/GGD-97, March 1997.

<sup>61</sup>GAO, *Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports*, November 7, 1996.

<sup>62</sup>49 USC § 47134(c)(2).

<sup>63</sup>See FAA, *Record of Decision for the Participation of Stewart International Airport, Newburgh, New York; In the Airport Privatization Pilot Program* at 21 (2001).

<sup>64</sup>11 USC § 362(b)(4).

<sup>65</sup>26 USC 147—Sec. 147. Other requirements applicable to certain private activity bonds.

**Table 6.4. Summary of incentives/disincentives to partial and full privatization.**

Issue	Partial Privatization	Full Privatization
FAA Approval	May or may not be needed, depending on structure and terms	Necessary and can deter
Revenue Use	Not a barrier	Requires express exemption
Grant Eligibility	Public entity remains sponsor and eligible	Entitlements only available through APPP; lower discretionary federal share for airports in APPP
Grant Repayment	n.a.	May not be required if remains an airport
Control over Aeronautical Activities	Subject to grant assurances and AHTA standards	Under APPP, subject to caps, grant assurances, and AHTA reasonableness standard Outside APPP subject to grant assurances
Control over Non-aeronautical Activities	Viable revenue source resulting from flexibility to control rates	Viable revenue source resulting from flexibility to control rates

- The APPP permits U.S.DOT to grant an exemption from the prohibition on revenue diversion “to the extent necessary to permit the purchaser or lessee to earn compensation from the operations of the airport.” FAA guidance indicates that a private operator acting outside of the APPP would be subject to all of the grant assurances, presumably including the prohibition on revenue diversion. However, the FAA has acknowledged that a private operator may have a limited right to recover its initial investment and earn some measure of compensation for managing the airport.

Table 6.4 presents a summary of the legal incentives and disincentives under partial and full privatization.

Airports participating in the APPP must also satisfy nine conditions prescribed by Section 47134 (as described earlier).

The sale of U.S. public airports is very uncommon, primarily due to the federal restrictions. Under the APPP, only general aviation airports can be sold.

## 6.5 Frequently Asked Questions About Full Privatization

The following is a short summary—in the form of questions and answers—concerning the principal legal issues presented by full airport privatization within and outside of the APPP. The underlying source material (statutes, regulations, guidance, etc.) is provided in Appendix D.2.

*Is FAA approval required for sale or lease to a private operator?*

Yes. The sale or lease of an airport to a private operator, within or outside of the APPP, requires FAA approval.

*What conditions apply to FAA’s consideration of a request to sell or lease an airport to a private operator?*

Airports participating in the APPP must satisfy nine conditions prescribed by Section 47134. For privatization outside

the APPP, the FAA requires that private operators agree to assume responsibility for the grant assurances, Surplus Property Act deed restrictions and other federal obligations. The FAA has not indicated what other conditions might apply to privatization outside of the APPP.

*Is the public airport owner or the private operator responsible for compliance with the grant assurances upon transfer?*

For privatization within or outside the APPP, the private operator will be responsible for compliance with the grant assurances, at least for so long as the grant assurances might otherwise remain applicable. Also, FAA may require that the public airport operator in either circumstance concurrently maintain responsibility for certain grant assurances.

*Will sale or lease proceeds constitute “airport revenue”?*

Yes. Sale or lease proceeds to any private operator will constitute airport revenue. However, an applicant under the APPP can request an exemption permitting the public airport operator to use sale or lease proceeds for non-airport purposes (see next question).

*What restrictions apply to a public airport owner’s use of sale or lease proceeds?*

Under the APPP, the Secretary may grant an exemption permitting the public airport owner to use sale or lease proceeds for non-airport purposes upon approval by 65% of air carriers, by number and landed weight, at a primary airport, and upon consultation with 65% of based aircraft at all other airports. If the applicant does not seek or obtain consent or conduct the required consultation, and for airports privatizing outside the APPP, the public airport owner is required to use sale or lease proceeds for airport purposes.

*Is a public airport owner required to reinvest or repay the federal government when selling or leasing property acquired with “federal assistance”?*

Maybe. Section 47134 explicitly permits U.S.DOT to excuse any reinvestment or repayment obligation. In 2009, the FAA clarified that public airport operators privatizing outside the APPP will not have to reinvest or repay prior grants so long as the airport continues to be made available for public use.

*Is a public airport owner permitted to use sale or lease proceeds to repay the General Fund for prior contributions to the airport?*

Yes. Whether or not privatizing under the APPP and whether or not a public airport operator receives approval by air carriers, the public airport operator can repay loans made by the sponsoring government within the preceding six years. The public airport operator likely can also repay loans made by a sponsoring government pursuant to written obligations, whether or not issued within the preceding six years.

*What restrictions apply to a private operator's use of revenue generated from the airport?*

Section 47134 permits U.S.DOT to grant an exemption from the prohibition on revenue diversion "to the extent necessary to permit the purchaser or lessee to earn compensation from the operations of the airport." FAA guidance indicates that a private operator acting outside of the APPP would be subject to all of the grant assurances, presumably including the prohibition on revenue diversion. However, the FAA has acknowledged that a private operator may have a limited right to recover its initial investment and earn some measure of compensation for managing the airport.

*What restrictions apply to a private operator's imposition of rates and charges?*

Section 47134 limits increases in fees imposed on air carriers to the rate of inflation without approval by 65% of air carriers (by number and landed weight), and limits the percentage increase in fees to General Aviation to the percentage increase charged to air carriers. While not subject to the AHTA's demand that rates and charges be "reasonable," a private operator outside of the APPP would be subject to the reasonableness and unjust discrimination standards imposed by the grant assurances.

*Is a private operator eligible for apportionment from the AIP Entitlement Fund?*

Section 47134 explicitly authorizes a private operator to receive an apportionment from the Entitlement Fund. Private operators acting outside the APPP are not eligible for an apportionment.

*Is a private operator eligible for grants from the AIP Discretionary Fund?*

Yes. Section 47109 provides that the federal share for discretionary grants for airports privatized under the APPP shall be 70%. Private operators outside the APPP may be eligible for discretionary grants if the airport is a reliever airport or receives 2,500 annual passenger boardings.

*Is a private operator authorized to impose a Passenger Facility Charge?*

Section 47134 explicitly authorizes a private operator to impose a Passenger Facility Charge. While private operators acting outside the APPP technically are not eligible to impose a Passenger Facility Charge, private operators may impose charges on enplaning passengers.

*Is a private operator required to separately obtain an Airport Operating Certificate?*

Yes. A private operator, within or outside the APPP, is required to request, secure and maintain an Airport Operating Certificate if the aeronautical activity at the airport demands a certificate.

*Is a private operator required to maintain an Airport Security Program?*

Yes. A private operator, within or outside the APPP, is required to maintain an Airport Security Program, depending on the nature and type of commercial passenger service.

*Is the public airport owner or the private operator obligated to provide law enforcement at the airport upon transfer?*

A private airport operator, within or outside the APPP, must provide law enforcement personnel or ensure that law enforcement personnel are available to respond to an incident, depending on the type of Airport Security Program in place at the airport.

## **6.6 Relevance and Lessons Learned From International Airport Privatization and Non-Airport Privatization in the U.S. Transport Sector**

As noted above, unlike in the United States, international airport privatization often means the full or partial transfer of airport ownership from the public sector to the private sector through very long-term leases or concessions, an outright sale, or IPOs (i.e., full privatization). This transfer of control and/or ownership is often accompanied by requirements to improve the airport's infrastructure and service levels and provide new capacity to keep pace with demand under a regulatory framework for aeronautical charges. Similarly, most of the non-airport transport examples entail long-term concessions or leases of the entire asset (i.e., also full privatization).

While there is a significant body of information to be learned from these experiences (as can be found in Appendices C and D), not much of it is transferable to the U.S. airport sector given the unique regulatory, finance, and legal framework in the United States as described earlier.

Some of the themes and lessons learned of relevance to U.S. airport transactions include:

1. Long-term concessions may have the advantage of enabling the owner to participate in the continuing success of the airport through securing returns from rental payments or performance-related payments. This may have particular advantages for some sorts of privatizations where buyers would be unwilling or unable to make high upfront payments.
2. The success of these deals (ranging from 30 to 99 years) cannot be determined in the short term. Also, the length of a concession needs to be considered carefully. In particular, longer terms raise more upfront money, but do not necessarily deliver overall best value for money. To date the term of long-term leases or concessions for “brown-field” surface transport assets has been driven, at least in part, by accounting treatment and tax exposure, and the same rules apply to airports where the useful life of existing terminals can be 30–40 years. This suggests a 50-year term should be adequate for depreciation treatment on airport deals, and depending on the age of the airport, possibly less. In the case of the Chicago Skyway, the bridge had major components with a long useful life of 75 or more years, which led to the 99-year term and the city of Chicago seemed comfortable carrying the 99-year term over to Midway to maximize the upfront payment, but this term does not appear to have been driven by tax or accounting considerations. However, while a longer term does raise more upfront money, it should be remembered that it does not necessarily deliver overall best value for money.
3. Although funding constraints may be a key factor in moving a public sector body to consider privatization, value for money must be the main rationale. For example, the adoption of 63-20 financing<sup>66</sup> may have appeared to offer a low-cost funding solution, but the resultant misalignment of risk and reward did not always deliver value for money. Further, award criteria should not simply focus on price and, as value for money in its widest sense should be

the objective, the inclusion of other considerations, such as environmental benefits, is both possible and beneficial. For airports, the consideration of wider economic and environmental benefits, and their inclusion within award criteria, is highly relevant.

4. Similarly, in measuring the success of a transaction, while the amount of the money received is an important consideration, it should not be the only criteria. It is also important to consider the investments made by the private entity in infrastructure, the level of service provided, the pricing of services to the public, the degree of environmental stewardship, and employee satisfaction. Airports, like all transportation infrastructure, do not operate in isolation, and have the same duties of care to stakeholders as other businesses. As such they must learn to balance simple monetary gains against these other wider considerations when considering privatization options.
5. The letting of concessions delivers a stable financial environment to address maintenance needs of economically critical infrastructure, and this appears to remain true even if the project finances fail. Indeed, many have argued that, even when projects failed financially, it should always be remembered that much needed essential economic infrastructure was delivered when it was needed, and often decades ahead of when it would have been delivered using traditional funding approaches. However, to ensure full public support, the public sponsor also needs a clearly articulated plan for how any additional proceeds raised by the public sector are to be invested, especially when revenues are being raised from one sector (such as an airport) to finance another (such as highways or other social facilities).
6. The early years of a concession are the most vulnerable and the public sector has an important role to play in mitigating risk in these early years. The public sector must also appreciate the expectations of the market and deliver a transparent and timely procurement process. Valuing and then correctly allocating risk is central to delivering value for money for the public sector and, hopefully, ensuring a successful outcome for all the parties involved. In recent years, the aviation industry has experienced volatile market demand and conditions, usually as a consequence of events beyond the industry’s control. Airport owners need to consider whether some form of government involvement whether to mitigate market risk, help provide some degree of credit enhancement, or defer rental payments in the critical early years of a concession delivers better value for money. In fact, as noted in the JFKIAT case study, the Port Authority of New York and New Jersey had to step up and provide completion financing in the context of the 2001 recession and the September 11th terrorist attacks. Also, Massport had to assist Delta in its bankruptcy

<sup>66</sup>63-20 financing refers to the issuance of tax-exempt bonds by non-profit entities to finance tangible public assets pursuant to IRS revenue ruling 63-20 of 1963, typically under long-term leases. For example, the 63-20 financing structure has been used to build hospitals, toll roads/bridges, university buildings, city halls, water and sewage facilities, hotels, and convention centers.

reorganization efforts for Terminal A at Boston Logan Airport to avoid the potential for costly litigation. This is a new form of cooperation in response to market failures of previous toll roads and other privatized assets.

7. For strategic transportation projects, the role of the private sector is seen as one of delivery, not of definition or specification. A solicited approach to privatization procurements allows the public sponsor to maintain control of project identification (and therefore the overall strategy for the project and sector) while ensuring the private sector is focused on the areas where it can best deliver value for money, namely, delivery of the service required.
  8. Although projects may appear to be similar, all have unique features, and these must be understood when developing the term and nature of the deal between the public and private sectors. Also, even the most technically complex project can be procured through privatization techniques. However, the involvement of the private sector cannot fundamentally change the nature of a project. For example, a project that needs a significant subsidy if procured by traditional means will still need a subsidy if procured as a privatization. In addition, even infrastructure of regional or national importance can, in principle, be procured through privatization techniques.
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## CHAPTER 7

# Other Examples

Some forms of private sector involvement do not fit into the generic models discussed earlier, but are worthy of mention and are described here.

### 7.1 Green-Field Private Airport Development

As indicated earlier, the direct and indirect federal controls on airports are largely the result of federal financial assistance to the airport. The legal structure applicable to an airport developed on a green-field site by a private entity without federal financial assistance is dramatically different. The private developer/operator would not be constrained by the grant assurances, statutory requirements applicable only to public entities (e.g., the Anti-Head Tax Act or AHTA), and statutory requirements applicable to entities that have received federal assistance at some point in the past (e.g., the statutory prohibition on revenue diversion found at 49 U.S.C. § 47133).

Further, while it is possible that a private airport developer/operator would be deemed a “state actor” responsible for guaranteeing the rights and protections afforded by the U.S. Constitution (e.g., on the basis that operating a public-use airport is a public function), private airport developers/operators are less likely to be deemed bound by the U.S. Constitution. If subject to the Constitution, a private airport developer/operator’s rates and charges likely would need to satisfy the rather favorable standard applied to public airport owners prior to the enactment of the AHTA.<sup>67</sup>

Freed from these constraints, a private developer/operator could, for example, do the following:

1. Impose user fees directly on passengers, likely subject to constitutional limits.<sup>68</sup>
2. Permit only certain air carriers to serve the airport.
3. Divert revenue from the airport.

At the same time, a private developer/operator would not enjoy several of the benefits and protections afforded government entities. In particular, the private developer/operator would *not* (1) be able to issue tax-exempt debt, (2) be eligible for state constitutional and statutory exemptions from property taxation, and (3) enjoy state action immunity from liability under the federal anti-trust statutes.

There have been a few examples of private airport development of airports, most of which have been for general aviation airports.

#### 7.1.1 New General Aviation Airport

There are numerous examples of privately developed general aviation airports in the United States. For example, Houston Executive Airport was built with private funds by WCF, LLC, which was founded by a Houston-area pilot and business executive. The airport is located 28 nautical miles west of the central business district of Houston, comprises 1,280 acres, has a 6,610-foot runway, and offers aircraft hangars and business aviation terminal facilities. The airport is designed for the business aviation community and general aviation pilots (not for commercial Part 121 carriers) as an alternative to the area’s more crowded commercial service air carrier

<sup>67</sup>See *Evansville-Vanderburgh Airport Auth. v. Delta Airlines*, 405 U.S. 707 (1972) (The U.S. Supreme Court held that a fee is constitutional if it (1) is based on some fair approximation of the use or privilege, (2) does not discriminate against interstate commerce, and (3) is not excessive in comparison with the benefit conferred.).

<sup>68</sup>In considering the legality of an “airport facility charge” imposed by the private operator of the Branson Airport, DOT found that neither the AHTA nor the PFC statute applied, since the airport operator was not a public entity, but reserved judgment on whether the “reasonableness” requirement of 49 U.S.C. § 47129 applies to a private airport operator. Letter from S. Podberesky, DOT, to G. Wicks re: Branson Airport’s Airport Facility Charge Request (Jan. 16, 2009).

airports. Construction started in November 2005 and the airport opened in January 2007.<sup>69</sup>

### 7.1.2 New Passenger Commercial Service Airport

Branson Airport is the only privately owned commercial passenger airport in the United States. It was built as a new airport on a green-field site by private investors to be operated as a for-profit business without the aid of federal or state grants. The airport opened in May 2009 with a 7,140-foot runway capable of handling 737s and 757s, a modest 40,000-square-foot terminal with four ramp loading gates, a contractor-operated control tower, and extensive general aviation facilities to serve the popular country-western music and entertainment tourist destination of Branson, Missouri. Prior to its opening, the nearest airport with scheduled service to Branson was 52 miles away (in Springfield) and offered virtually no service by low-cost carriers.

A group of entrepreneurs created Branson Airport LLC, acquired a parcel of land in Branson, received airspace approvals from the FAA, negotiated a 30-year agreement with the City of Branson to pay the airport \$8.24 for each arriving visitor (with an annual cap of \$2 million), and raised \$27 million in equity and \$111 million in tax-exempt revenue bonds to pay for the airport development. The \$8.24 per arriving passenger represents a subsidy from the city's general fund for the private airport. Branson Airport LLC retained Aviation Facilities Company, Inc. (AFCO) to oversee construction of the airport.

Because Branson Airport LLC did not accept federal AIP grants for the airport, it is not constrained by FAA grant assurances. As a result, Branson Airport LLC has been able to offer airlines exclusive rights to provide commercial service from specific cities to the airport. In return, the airlines are required to offer low fares that are negotiated between Branson Airport LLC and the individual airlines. For example, Branson Airport LLC signed up AirTran for exclusive service to Atlanta and Milwaukee as well as Sun Country for service to Minneapolis-St. Paul and Dallas. Branson LLC and its affiliated travel agency also started a scheduled charter service with ticket prices they determine in consultation with the airports at the other end of the routes. In addition, Branson Airport LLC signed an exclusive rental car agreement with Enterprise Rent-A-Car, which is unusual in the airport industry.

However, although Branson Airport LLC may assess an airport facility charge on passengers using the airport, air carriers are not permitted to separately list an airport-assessed airport facility charge from their advertised fares for air transportation to and from the airport (a PFC, in contrast, is separately listed from the base ticket price). According to the U.S.DOT,

<sup>69</sup>FAA Airport Master (Form 5010 PDF), July 31, 2008; and Houston Executive Airport, official website.

because the company will be operating the airport as a private entity, the airport facility charge is not a government-imposed charge and may not be advertised separately from the fare for air transportation in compliance with the U.S.DOT's full fare advertising rule set forth in 14 CFR 399.84 and its more than 20 years of enforcement case precedent.

Since its opening, which was one month before the end of the longest recession in U.S. postwar history, Branson Airport LLC has struggled to meet traffic projections. In 2010, Branson Airport LLC (1) suffered a \$2.2 million operating loss for the first six months of the year, (2) had to dip into reserves to cover its July 1, 2010 debt service payment, (3) reached an agreement with the city to make its payments directly to a nonprofit transportation district instead of the airport to forward to the trustee for debt service, and (4) needed the investor group behind the airport to pump in an additional \$22 million to support operations.<sup>70</sup> After falling into a technical default on its bonds in January 2011, Branson Airport LLC entered into a forbearance and funding agreement with the bondholder's trustee, which staves off enforcement actions (until June 30, 2012) to give the airport time for services and revenues to "become sufficient to meet all operating and debt service costs," allowing the company to "stabilize its business."<sup>71</sup> On the basis of projections in the bond offering statement, the company believed 180,000 travelers would use the airport in 2009 rising to 275,000 in 2010. However, in 2010 the airport served only 92,000 passengers.

## 7.2 Examples of 'Reverse' Privatization

There are also examples where (1) certain functions that were privatized have reverted back to public control or ownership and (2) public airport owners provide services to the private sector. As noted above, Stewart International Airport, which was privatized under the APFP in 2000, reverted back to public ownership in 2007 when National Express sold its interest in the airport to the Port Authority of New York and New Jersey. Also mentioned earlier both Indianapolis and Harrisburg reverted back to public management of their airports after a number of years of private operation by BAA. Other examples are described here.

### 7.2.1 In-sourcing Services

Clark County, the owner and operator of Las Vegas McCarran International Airport, has been replacing private contractors with county workers by in-sourcing a number

<sup>70</sup>Yvette Shields, *Branson Hits Turbulence*, The Bond Buyer, August 4, 2010.

<sup>71</sup>Yvette Shields, *Branson Airport Gets Forbearance*, The Bond Buyer, May 11, 2011.

of functions. In the early 1990s, the county took over the responsibility for cleaning of all leased areas in public view, including the baggage claim area, the gate holdrooms, and the area in front of the ticket counters, from the airlines. The county did this because the service provided by the airline contractors was not performed to an acceptable standard for the airport. This function was added to the county's in-house custodial staff resulting in an increase of approximately 100 custodial staff to cover existing and new space added over time. The county believes that while its cost for performing this work is higher than what the airlines were spending, the standard of cleanliness is much greater than it was when the airlines performed this function.

In 1990, all of the baggage handling systems were owned, maintained, and operated by the airlines with the exception of the baggage claim system, which the county owned and maintained. As the airport transitioned to a common use operation, it started to bring this function in-house. The county started assuming control over certain ticket counter and bag make-up areas as those areas became true common use facilities. When the county installed its in-line baggage screening system, it had to replace most of the baggage handling systems, which was done as one integrated project. At the end of the project, the county owned all of the baggage handling systems (except for the one used by Southwest Airlines, which it subsequently bought) and now owns and maintains all of the baggage handling systems at the airport. Maintenance of the baggage system is performed in-house. Initially, the county maintained part of the system with in-house staff and part with an outside contractor (split roughly 50/50), but found that the part that was maintained in-house was better maintained than the portion maintained by the outside contract for the same or slightly less cost. As a result, the county brought all of the maintenance in-house.

In the early 1990s, the airlines owned most of the jetways at the airport. The airport standard at that time was for airlines to provide and maintain jetways for their leased gates. After an incident where the county encountered difficulty relocating one airline to another terminal due to its ownership of the jetways, it was decided that the county should own all the jetways to avoid these constraints as it sought to maximize the utilization of the terminals. This was accomplished over time as new gates were added and as the county bought airline jetways on existing gates. The county now owns and maintains in-house all of the jetways at the airport.

### **7.2.2 Public Airport Providing Private Contract Services**

The Allegheny County Airport Authority, which operates Pittsburgh International Airport, provides an interesting example of a public owner providing a private function to

a private company. In September 2009, the airport authority entered into an agreement with JBT Aerotech (an airport ground support equipment and services company) to renovate jetways for JBT Aerotech's customers east of the Mississippi River. The airport hopes to generate up to \$500,000 from this service contract.<sup>72</sup> After US Airways de-hubbed its Pittsburgh operations, the authority had less equipment to maintain for the airport and creatively re-deployed its maintenance staff initially by refurbishing and selling excess jetways and by contracting out its trained staff to JBT Aerotech.

### **7.2.3 International Airport Privatization Services**

The Houston Airport System manages three airports (George Bush Intercontinental, William P. Hobby, and Ellington Airport) and leverages its planning, development, and operating experience from these airports to provide airport professional services in the international arena. The Houston Airport System participates in the international market for airport privatization and strategic development services through its HAS Development Corporation (HASDC), a Texas nonprofit corporation. HASDC participates in bids for airport concessions globally and markets its expertise for the operational, commercial, and financial development of airports around the world. For example, HASDC is one of four partners in Quiport Corp. which developed and manages the new Quito Airport in Ecuador.

### **7.2.4 Private Airport Reverting to Public Ownership and Operation**

In January 2010, Deutsche Post DHL announced it would deeded the privately owned Wilmington Air Park in Ohio to Clinton County Port Authority as a result of DHL's pullback from the domestic U.S. market. DHL acquired Wilmington Air Park when it bought freight carrier Airborne Express, which owned the airport and used it for its central sorting hub. DHL had previously sorted packages at the Cincinnati Northern Kentucky International Airport (CVG), but consolidated operations at Wilmington after the acquisition. The state of Kentucky offered DHL a \$1.87 million tax credit to make CVG its hub, which led DHL to close its Wilmington Air Park hub. As of August 2010, the future of Wilmington as an airport is in question. Wilmington Air Park was the former Clinton County Air Force Base and is equipped with a control tower and two runways with lengths of 10,701 and 9,000 feet.

<sup>72</sup>*Allegheny Airport Authority to Renovate Jetways for Airports*, Pittsburgh Tribune Review, September 12, 2009.



## CHAPTER 8

# Decision Tree Matrix, Evaluation Checklist, and Process

Each airport owner has different reasons for considering some form of airport privatization. Therefore, it is important to put these goals and objectives into context when considering which solution may be most appropriate under the circumstances. The primary purpose of this chapter is to help the reader understand the process and considerations for identifying and evaluating realistic options for private sector involvement in airport management, operation, and finance and when, why, and how to employ the private sector in light of the airport owner's objectives.

### 8.1 Decision Tree Filter and Matrix

The process for considering various forms of privatization involves a multi-step process starting with identification of the owner's goals and objectives, familiarization with the specific strategies available, comparison of those goals to those of other stakeholders, identification of ways to mitigate stakeholder risks, review of the transaction's complexity and risk, and valuation of the transaction (Figure 8.1). The key to achieving the highest probability of success is to be both well-informed and rigorous about the evaluation process, while accounting for the diversity of stakeholder views.

Figure 8.2 summarizes the range of privatization models or families of options.

Table 8.1 provides an overview and guide for selecting a privatization business model based on an airport owner's assessment and prioritization of goals and the level of difficulty and complexity to implement the strategy.

The further an airport progresses along the privatization continuum, the more complicated the effort becomes, and while the stakes get higher, so do the potential rewards.

### 8.2 Owner's Goals and Objectives

In considering which, if any, of the privatization models are appropriate for a particular airport, the first step would be to identify the airport owner's and the community's specific

goals and/or the problems to be addressed. This would allow for an initial screening of the alternatives that are best suited to the situation. As part of this analysis, the airport owner and its constituents should also consider options available under the current public model (e.g., transition to an airport authority).

The identification of goals and objectives can derive from an internal planning exercise, input and direction from elected and appointed officials, and public outreach. This process will benefit from rigorous and contemporary airport planning, in the form of, for example, an airport master plan, airport system plan (if applicable), business plan, or strategic plan.

As illustrated in Table 8.2, some techniques do not fit certain goals, in part due to the strictures of federal law and policy.

There are numerous issues that may arise in attempting to align the airport owner's objectives with the privatization models. For example, if the primary objective is for the public owner to extract a lump sum cash payment, the only model that could meet that goal would be privatizing under the APPP, with airline approval at primary airports. In this case the term of the lease is an important consideration because the longer the term, the higher the potential payment. If the primary objective is to reduce airport debt, this could be achieved by full privatization under the APPP or outside the APPP. At the other end of the spectrum, if the owner wanted to reduce costs for its airline tenants while maintaining as much control as possible, it might consider service contracts.

Under airport-wide management contracts, when acquiring services on behalf of the public owner, the operator may or may not be released from public procurement regulations, which is often a driving motivation in privatization efforts. This should be determined in advance based on procurement laws. For example, for the Indianapolis Airport Authority, BAA's procurement of goods with their own operating funds was not considered public dollars in the same way as the authority's funds.

Single-purpose airport authorities are not as likely to be attracted to full privatization under the APPP because one

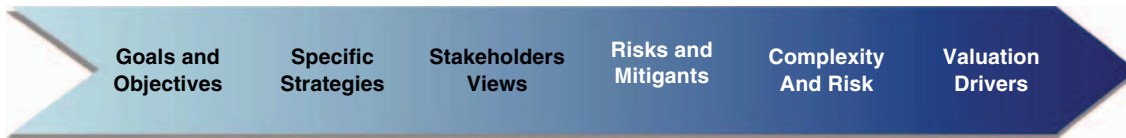


Figure 8.1. Decision tree filter.

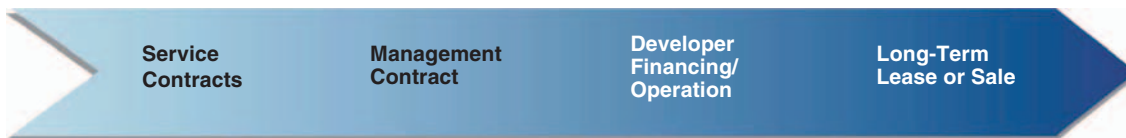


Figure 8.2. Airport privatization continuum.

Table 8.1. Guide for selecting a privatization model.

Factor	Attributes/Issues
<b>Service Contracts</b>	
Legal	Relatively easy to implement
Regulatory	Limited regulatory hurdles
Governance	Relatively limited monitoring and compliance (administration, not policy formulation)
Financial	Limited staffing and out-of-pocket expense required by owner
Internal-economic	Potential to reduce costs for tenants and users
External-economic	Limited or no economic development benefits
Commercial	Lower private sector employment and overhead costs
<b>Management Contracts</b>	
Legal	Limited legal constraints
Regulatory	No special conditions required to implement under current laws
Governance	Significant monitoring and compliance for owner; relatively easy exit
Financial	Limited staffing and out-of-pocket expense required by owner
Internal-economic	Potential to improve financial operations of the airport
External-economic	Limited economic development benefits
Commercial	Relatively small compensation for private operator
<b>Developer/Project Finance and Operation</b>	
Legal	Complicated legal constraints to conform to bond indentures
Regulatory	Compliance with federal grant assurances and IRS regulations
Governance	Limits administrative burden and staffing responsibilities of owner with limited follow-on monitoring once transaction is complete
Financial	Potential to create significant financial improvements via capacity for commercial enhancements and cost savings; offloads debt and risk to private sector
Internal-economic	Transfers risk exposure to private sector
External-economic	Significant potential for economic development benefits
Commercial	Good opportunity to generate profits for private companies
<b>Long-Term Lease or Sale</b>	
Legal	Significant legal hurdles, including property tax exemption and labor contracts
Regulatory	Most extensive regulatory hurdles (federal, state, local) and potentially airline approval requirement
Governance	Upfront risk; modest amount of ongoing monitoring and compliance; difficult to exit
Financial	Highest out-of-pocket expense to accomplish
Internal-economic	Uncertain outcome
External-economic	Potential for significant economic development benefits; upfront financial benefits with long-term risks
Commercial	Strong potential to generate profits for private companies

Table 8.2. Owner’s goals decision tree matrix.

Goals and Objectives	Partial Privatization			Full Privatization <sup>1</sup>	
	Service Contracts	Management Contracts	Developer Financing/ Operation	Inside APPP	Outside APPP
Maintain community control of airport operation and development decisions	X	X			
Secure operating efficiencies	X	X	X	X	X
Introduce innovative revenue enhancements	X	X	X	X	X
Eliminate airport subsidies	X	X		X	X
Reduce airline costs	X				
Convert underutilized facility into economic catalyst		X	X	X	X
De-politicize airport decisions		X	X	X	X
Address identified deficiencies in airport management		X		X	X
Advance ideological interest in private sector participation		X	X	X	X
Address improper conduct, e.g. corruption		X		X	X
Access private capital			X	X	X
Accelerate project delivery			X	X	X
Reduce construction costs			X	X	X
Transfer construction risk			X	X	X
Minimize organizational disruption			X		
Use sale or lease proceeds for non-airport purposes				X*	
Repay airport debt				X	X

\* Only with 65% airline approval at primary airports.

<sup>1</sup> “Full privatization” includes outright sale and long-term lease. For example, the proposed long-term lease of Midway would fit in this category. Greenfield private development is not considered privatization.

major appeal for this option is the ability to extract a cash outlay to fund other government programs, and there may be little interest, incentive, or ability for an airport authority to transfer sale or lease proceeds to a general purpose government.

In general, if the motivation is extracting revenue from the airport, well run airports are poor candidates for any of the privatization models because it will be more difficult to extract cost efficiencies and uncover revenue opportunities from the future operation. However, they may have available land or other property that is underutilized that could be developed by a private operator as a source of additional revenue.

Motivations for private sector involvement for the airport case studies are summarized in Table 8.3. In many cases, the objectives reflected a belief that a private sector operator with airport expertise could achieve the stated goals better than a public sector operator.

### 8.3 Stakeholder Views

As public entities, airport owners face competing demands from various stakeholders that could be affected by a change in activities that were once performed by government that are

turned over to private entities. It is important to understand how these key parties perceive the change in operation and how it might affect their use of the airport.

After an initial screening of the privatization models with respect to the airport owner’s goals, the next step would be to consider the perspectives and range of acceptance by major stakeholders for the models under consideration.

It is important to remember that stakeholder views depend upon the unique circumstances for each airport and the means by which the public owner chooses to implement privatization. In addition, some stakeholders are more vocal than others. Communities may need to engage the stakeholders directly about the opportunities and concerns at the airport. While the information provided in this chapter can help guide an airport, it is not a substitute for airport specific information. Some communities approach this through consultant studies, blue-ribbon panels, and working groups. Often the structure of the process can have an effect on the outcome. So care should be taken to avoid biasing the process.

The research team surveyed key stakeholder groups to document their issues and concerns regarding privatization

Table 8.3. Summary of motivations for private involvement for case study airports.

<p><b>Airport-wide Management Contract</b></p> <p><i>Indianapolis Airport Authority</i></p> <ul style="list-style-type: none"> <li>▪ Attract new airline service and encourage economic development by reducing airline costs through increased nonairline revenues and reduced operating expenses</li> <li>▪ Improve customer service and quality</li> <li>▪ Increase the expertise and diversity of Airport staff</li> </ul>
<p><b>Developer Financing and Operation</b></p> <p><i>John F. Kennedy International Airport Terminal 4 (JFKIAT)</i></p> <ul style="list-style-type: none"> <li>▪ Preserve financing capacity for the Port Authority's 5-year capital program</li> <li>▪ Minimize construction risk and management oversight</li> <li>▪ Reduce operational responsibilities</li> <li>▪ Deliver a functional terminal on time and on budget with no additional financing required by the Port Authority</li> <li>▪ Improve operational efficiency and increase terminal capacity by replacing exclusive use arrangements with common use arrangements and new pricing approaches</li> <li>▪ Gain PPP experience for possible deployment to other agency operations</li> </ul>
<p><b>Boston Logan Terminal A</b></p> <ul style="list-style-type: none"> <li>▪ Introduce private sector participation into airport operations</li> <li>▪ Redevelop Terminal A while preserving the Authority's financing capacity for its sizable capital program</li> </ul>
<p><b>Long-Term Lease Inside the APPP</b></p> <p><i>Stewart International Airport (SWF)</i></p> <ul style="list-style-type: none"> <li>▪ Leverage the expertise of the private sector to develop the underutilized airport to its fullest potential</li> <li>▪ Develop the real estate on the vast site to create jobs and economic development, which was a priority for the Hudson River Valley due to large industrial concerns laying off workers and closing plants at the time</li> <li>▪ Get out of the business of managing airports</li> <li>▪ Introduce private sector participation into airport operations</li> </ul>
<p><b>Chicago Midway International Airport</b></p> <ul style="list-style-type: none"> <li>▪ Maximize sale proceeds for the city's unfunded pension liability, infrastructure improvements, and other general fund purposes (primary objective)</li> <li>▪ Establish a new framework of rates and charges that provides lower and more predictable rates for airlines operating at the Airport</li> <li>▪ Improve the competitive position, service quality, growth prospects and efficiency of Midway Airport for the benefit of Chicago residents, airlines, and other users</li> <li>▪ Ensure that future Airport development is safe, functional, efficient and delivered when necessary</li> <li>▪ Minimize the City's exposure to residual risks and liabilities from the process</li> <li>▪ Ensure fair and equitable treatment of existing Airport employees</li> <li>▪ Ensure a smooth transition from public to private management in a timely manner</li> </ul>
<p><b>Long-Term Lease/Management Contract Outside the APPP</b></p> <p><i>Morristown Municipal Airport</i></p> <ul style="list-style-type: none"> <li>▪ Pay off \$2 million in airport long-term debt</li> <li>▪ With the aid of federal and state grants, make substantial upgrades to the airport's infrastructure that was in a state of disarray with the airport's corporate users threatening to leave and the FAA threatening to close the facility if upgrades were not made to the airport</li> <li>▪ Turn the airport into an economic catalyst for the town and the region</li> </ul>

and their perspectives on the potential advantages and disadvantages. Table 8.4 summarizes the key interests of each stakeholder group. Appendix G provides a full description of the perspectives of the key stakeholder groups.

## 8.4 Complexity, Risk, and Other Implementation Issues

An important consideration in evaluating potential privatization models is the level of complexity and risk to implement the action. This is particularly important in the public sector where officials tend to be risk averse. On a scale ranging from the least complex and risky to most complex and

risky, the privatization models generally can be ranked as shown in Table 8.5.

A detailed discussion of the logic behind these ratings can be found in the chapters for each strategy.

The size of the airport (in terms of passengers, aircraft operations, or revenue) can affect the consideration of the various private-sector options given the potential savings, revenues, implementation risk, and costs of the process. Given the high costs, complexity, and implementation risk associated with full privatization as well as the regulatory dis-incentives, there has been much greater experimentation with partial privatization in the United States. Only 82 of the 3,332 public-use airports in the United States are privately owned, and virtually

Table 8.4. Key stakeholder interests.

<b>Stakeholder</b>	<b>Key Interests</b>
<b><i>Policy Makers</i></b>	<ul style="list-style-type: none"> <li>▪ Ensure the airport is developed in a manner that promotes regional economic development</li> <li>▪ Create an operating environment that encourages increased passenger traffic</li> <li>▪ Raise money from a sale or lease of the airport to help pay for municipal budget deficits, pension deficits, infrastructure development, and other general purpose needs</li> <li>▪ Provide opportunity for operational efficiencies and revenue development</li> <li>▪ Provide access to private capital for airport improvements and development</li> <li>▪ Ensure the transaction is successful</li> <li>▪ Retain a degree of control over the airport assets (e.g., prices, CapEx, levels of service, noise mitigation, etc.)</li> <li>▪ Protect existing civil service employees</li> </ul>
<b><i>U.S. Airport Management</i></b>	<ul style="list-style-type: none"> <li>▪ Promote safety, security, airline service, customer service, financial stability, compliance with laws and regulations, non-aeronautical revenue development, operational efficiencies, labor stability, and other measures that enhance the reputation of the airport</li> <li>▪ Provide for the best interests of the tenants, passengers, and community over the long-term</li> <li>▪ Provide an opportunity for the government to monetize a government-owned asset (minority view)</li> <li>▪ Deploy P3 on a select basis to maximize the value to all stakeholders</li> <li>▪ Get relief from cumbersome public procurement rules and social policy mandates to operate airports more like a business than a unit of government</li> <li>▪ Reduce federal economic regulation to allow public airports more freedom</li> </ul>
<b><i>Airlines</i></b>	<ul style="list-style-type: none"> <li>▪ Reduce airline costs to operate at the airport</li> <li>▪ Provide greater predictability and stability in rates</li> <li>▪ Ensure efficient airline operations</li> <li>▪ Ensure operator meets stated operating standards</li> <li>▪ Provide sufficient capacity to accommodate demand</li> <li>▪ Provide quality level of service for passengers</li> <li>▪ Prevent monopolistic actions</li> <li>▪ Construct deal that makes business sense for the airlines</li> <li>▪ Permit consortiums for airline terminal equipment maintenance and fuel systems</li> </ul>
<b><i>U.S.DOT/FAA</i></b>	<ul style="list-style-type: none"> <li>▪ Protect the federal government's investment in airports</li> <li>▪ Ensure airports abide by and comply with federal laws and regulations</li> <li>▪ Provide capacity to accommodate future growth</li> <li>▪ Prevent actions that would discourage growth for national airport system</li> </ul>
<b><i>Privatized International Airports</i></b>	<ul style="list-style-type: none"> <li>▪ Promote safety, security, airline service, and customer service</li> <li>▪ Take actions to increase traffic levels, drive efficiency, introduce innovation, increase non-aeronautical revenues, and produce reasonable financial returns for investors</li> <li>▪ Align operator and airline interests through per passenger charges</li> </ul>
<b><i>Private Domestic Airport Operators</i></b>	<ul style="list-style-type: none"> <li>▪ Promote safety, security, airline service, and customer service</li> <li>▪ Maximize their financial return through operating savings, revenue enhancements, and high facility utilization</li> <li>▪ Expedite delivery of services relative to public sector rules</li> <li>▪ Minimize airline costs to the mutual benefit of the airlines, the operator, and passengers</li> <li>▪ Incentivize employees through bonuses, succession programs, and training</li> <li>▪ Prefer light handed regimes with no pricing regulation, because it provides the most flexibility</li> </ul>
<b><i>Lenders</i></b>	<ul style="list-style-type: none"> <li>▪ Receive timely repayment of debt obligations at a rate commensurate with the risk</li> <li>▪ Secure senior status on debt repayment</li> <li>▪ Be protected against refinancing risk</li> <li>▪ Lock up as much security as possible in the case of default</li> </ul>
<b><i>Investors</i></b>	<ul style="list-style-type: none"> <li>▪ Earn a reasonable return on investment, which is dependent on the amount of risk</li> <li>▪ See an appropriate balance between equity and debt to maximize returns</li> <li>▪ Minimize exposure to political and regulatory risk</li> <li>▪ Invest for the time horizon desired</li> <li>▪ Conduct the transaction under a transparent process</li> <li>▪ Have access to relevant data to conduct due diligence</li> <li>▪ Provide for a clear and credible timetable for the process</li> <li>▪ Minimize the cost of participating, especially in the initial round</li> </ul>
<b><i>Financial Advisors</i></b>	<ul style="list-style-type: none"> <li>▪ Provide the most advantageous conditions for the financial offering</li> <li>▪ Protect the airport owner's long-term financial interests</li> <li>▪ Maximize the potential for the transaction's success</li> <li>▪ Explain which risks can be passed to the private investors and which cannot</li> <li>▪ Develop a reasonable estimate of the value of the transaction and manage the government's expectations regarding the value of the transaction</li> </ul>

(continued on next page)

Table 8.4. (Continued).

Stakeholder	Key Interests
<b>Rating Agencies</b>	<ul style="list-style-type: none"> <li>▪ Assess potential for a project or airport to generate adequate cash flow to pay bondholders with special attention paid to risks and risk allocation (including refinancing risk) and flexibility to deal with adverse conditions</li> <li>▪ See debt fully repaid by end of the concession with an appropriate “tail period”</li> <li>▪ See strong legal provisions</li> <li>▪ Have the ability to withstand financial stress tests</li> </ul>
<b>Labor</b>	<ul style="list-style-type: none"> <li>▪ Protect employment stability, pensions, and compensation levels</li> <li>▪ Advocate policies that support a union-friendly outcome</li> <li>▪ Participate in all activities, including design, construction, maintenance, and operation</li> <li>▪ Ensure the interests of its members are protected</li> <li>▪ Maintain and expand the unionizing and collective bargaining rights of their members</li> </ul>
<b>Passengers</b>	<ul style="list-style-type: none"> <li>▪ Experience high-quality, fast, reliable, safe, hassle-free, and comfortable trip through airports</li> <li>▪ Be charged reasonable prices</li> <li>▪ Have access to a wide variety of concession opportunities and other amenities</li> </ul>

Table 8.5. Assessing complexity and risk.

Model	Complexity	Risk
Service contracts	Low	Low
Airport-wide management contract	Medium	Low
Developer financing/operation	Medium	Medium-High
Long-term lease or sale	High	High

all of them are general aviation airports. All but one of the 522 primary and commercial service airports<sup>73</sup> is owned by local or state governments.<sup>74</sup> Moreover, a majority of the applicants for the APPP have been small airports<sup>75</sup> that were underutilized, subsidized by the government owner, had either limited or sporadic commercial service, and served primarily general aviation.<sup>76</sup>

By contrast, most airport privatization transactions outside the United States have been for an airport that was of a

<sup>73</sup>Primary and commercial service airports are defined by the FAA as airports that (1) have scheduled passenger service, (2) enplane 2,500 or more passengers per year, and (3) are publicly owned.

<sup>74</sup>The notable exception is Branson Airport, which is the only privately owned commercial passenger airport in the U.S. that was developed on a green-field site.

<sup>75</sup>Four primary airports have applied—Stewart International Airport, Chicago Midway International Airport, Louis Armstrong New Orleans International Airport, Luis Muñoz Marín International Airport (San Juan, Puerto Rico)—of which only Chicago Midway and San Juan remain active. Six non-primary and general aviation airports have applied—Brown Field/San Diego Commerce Center, Niagara Falls International Airport, Aguadilla Airport (Puerto Rico), New Orleans Lakefront Airport, Gwinnett County Briscoe Field Airport (Georgia), Hendry County Airglades Airport (Florida)—of which only Gwinnett County and Hendry County remain active.

<sup>76</sup>FAA, *Report to Congress on the Status of the Airport Privatization Pilot Program, United States Code, Title 49, Section 47134*, at 2 (2004).

relatively material size in terms of passenger throughput or for a system or group of airports that included smaller airports. The likely reasons for this include:

- Privatization involves significant transaction costs, including legal and investment banking advice. For a small airport, those transaction costs are likely to represent a high proportion of the transaction value.
- Many smaller airports are not self-sustaining. Although there are several examples of airports with throughput of 1 million passengers per year or even lower that generate positive Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA), they are in the minority. Although it is not impossible, it is relatively problematic to attract investors to loss-making airports.
- Larger airports tend to have lower reliance on single carriers or routes, and therefore to have relatively lower risk profiles, which helps to make them more saleable.
- The lower risk profiles of larger airports also make the future investment frequently required easier to finance.

## 8.5 Valuation and Valuation Drivers

In evaluating airport privatization models, it also is important to estimate the potential value of the transaction for both the airport owner and the private operator. The transaction value will help determine if the potential financial rewards are worth the level of effort and associated implementation risk. The valuation process includes consideration of the key attributes of the facility followed by a projection of key metrics.

Privatization can generate value in the following ways:

- Enhancing non-aeronautical revenues
- Cost savings through optimized use of facilities
- Rightsizing CapEx—no overbuilding

- Efficiencies on procurement and purchasing functions
- Applying commercial business practices
- Aligning actions with the needs of different market segments (e.g., low-cost carriers)
- Realizing less political and lobbying influence
- Adopting a strategic and business approach to long-term needs

Because no two airports are alike, each airport will have different strengths and weaknesses. For example, small hub airports cannot expect to realize the same level of concession revenues per passenger as that of a major international gateway. Airports with an older, less efficient terminal are not able to provide the concession space needed to take full advantage of the market. Airports that are well run are weaker candidates for privatization because there is less value to be derived unless there is collateral land for development. But in virtually all cases there are structural inefficiencies inherent in government operation that could be improved by the private sector.

The value of the transaction can be affected by numerous factors, and depends on the type of privatization as follows:

#### ***Service Contracts***

- Condition of the facilities or equipment
- Current staffing levels
- Requirements to retain government staff if any
- Labor hiring conditions if any (collective bargaining agreements, full-time versus part-time, etc.)
- Peaking characteristics
- Operating and performance standards

#### ***Management Contracts***

- Condition of the facilities
- Potential for non-aeronautical revenue enhancement
- Potential for operational efficiencies
- Utilization of the facility and capacity to accommodate additional demand
- Amount of vacant space

#### ***Developer Financing and Operation***

- Scope of the transaction (one or more cargo buildings, terminal building, parking facilities, etc.)
- Responsibility for airside development and operations
- Condition of the facility
- Utilization of the facility and capacity to accommodate additional demand
- Exclusive franchise or competing facilities (other terminals, cargo facilities, parking facilities)
- Degree of competition from other on-airport facilities or alternative airports or other transportation forms
- Availability of tax-exempt financing
- Credit market conditions
- Availability of PFC revenues

#### ***Full Privatization (Inside or Outside the APPP)***

- Facility attributes
  - Multiple airport system or group (e.g., BAA in United Kingdom) versus single airport (e.g., Midway)
  - Condition of the facility
  - Utilization of the facility
  - Capacity to accommodate additional demand (airside, landside)
  - Degree of technological innovation
  - Undeveloped land potential
- Capital investments and funding
  - Level of investment required, including capital investments (CapEx), working capital, unfunded pension liabilities, etc.
  - CapEx triggers or mandated capital improvement program
  - Capital structure and ability to access tax-exempt debt
  - Credit market conditions and competing investment opportunities
  - PFC level and capacity
  - Return on asset base (RAB)
- Pricing power or constraints to pricing
  - Level of existing aeronautical charges (cost per enplanement or CPE) and contractual, regulatory, and practical potential to raise fees
  - Dependence on volume-based fees
  - Other aeronautical contractual agreements and associated terms
  - Non-aeronautical revenue per passenger
  - Constraints on non-aeronautical charges such as price caps or contractual agreements
  - Competition from off-airport vendors (parking, hotels, etc.)
  - CFC level
- Potential for operational efficiencies and operating expenses per passenger
- Underlying demand characteristics of the market, including:
  - Strength and diversity of the local economy
  - Business versus leisure oriented market
  - Demographics and income levels of the passenger base (population, employment base, unemployment rates, personal consumption, wealth levels, construction, and housing market conditions)
  - Enplanement base and volatility
  - Origination-destination (O&D) versus connecting passengers
  - Presence, scale, and potential for international passengers (gateway airports)
  - Degree of competition from alternative airports or other transportation modes
  - Airline diversity (versus domination by single airline)
  - Financial condition of dominant airline(s)

- Prominence of low-cost carriers versus legacy airlines, etc.
- Aircraft operations
- Cargo tonnage
- Other business terms and conditions
  - Length of lease or concession
  - Deed restrictions
  - Value of unamortized AIP grants and potential need to repay the grants
  - Shareholder structure and percentage of control offered to private sector
  - Detailed performance standards and associated penalties and incentives
  - Inherited collective bargaining agreements
  - Requirements to comply with government's procurement rules
  - Other external regulations (e.g., passenger volume cap, slot rules, noise rules, nighttime curfew)
  - Breakup or clawback terms

## 8.6 Financial Metrics

In attempting to value a transaction, it is important to consider the airport's ranking in a range of key financial metrics. The objective of this exercise is to investigate how a private entity would look at the opportunity, and what levers they could pull to enhance value.

Financial metrics for service contracts depend upon the nature of the contract, economies of scale, skill set and training, and compensation comparisons between public and private sector employees. The appropriate metrics should be carefully tied to the service quality standards desired. Measurable performance standards should be built into contracts as well as incentives for exceeding standards and penalties for underperforming.

Financial metrics for airport-wide management contracts can be difficult to estimate as described under the Indianapolis case study in Chapter 9 and Appendix H. Quantifying efficiency gains and revenue enhancements can be challenging in part due to defining a baseline and separating out the effect of changes in traffic, implementation of capital improvements, differences in inflation between baseline projections and actual experience, changes in expenses due to legal and accounting mandates, etc. Nevertheless, specific targets can be set regarding financial results, safety and security, customer service, operation and maintenance, and capital program management to evaluate performance on an annual basis against the baseline under public operation. As experienced in Indianapolis, it becomes harder and harder over time for the contractor to realize increasing savings.

Financial metrics for developer financing and operation depend on the type of facility. For passenger terminals, annual metrics could include operating expense per enplaned passenger, airline cost per enplaned passenger, concession

revenue per passenger, customer service, and cash flow (if the airport owner shares in the net revenue). The cost to deliver the project can be compared to the cost of development by a public airport owner for a comparable facility (e.g., cost per square-foot) after making sure the comparisons include the same project elements (e.g., turn-key versus tenant-financed finishes and equipment) and are adjusted for construction time period. For example, construction costs declined considerably after the financial crisis in 2008.

For full privatization, the financial metrics used relative to peer airports include:

- EBITDA<sup>77</sup> margin
- EBITDA per passenger
- RAB
- Airline Cost Per Enplanement (CPE)
- CPE rank
- Non-aeronautical revenue per passenger
- CapEx per passenger
- OpEx per passenger

A variety of valuation methodologies are employed:

- Cost-based methodologies, including historic cost and depreciated replacement cost
- Value based methodologies, including fair market value, net present value, and deprival value
- The concept of opportunity cost, representing the amount lost by not using the resource in its best alternative use
- Optimization—to remove inefficiencies that exist in the current asset configuration such as non-productive assets, duplication, excess capacity, and or redundant assets

Different options can be considered appropriate for valuing different categories of assets.

Table 8.6 summarizes how a private consortium would view a potential airport investment opportunity (non-aeronautical revenues would be generally viewed as the area with the highest potential for value enhancement, as these revenues are less regulated, providing a relatively high degree of flexibility) and often are not fully exploited by public authorities. The drivers and associated potential to enhance value for each metric are likely to be different depending on the underlying structure of the privatization arrangements.

For example, duty free revenues would be influenced by the level and nature of international passenger departures and by the current spend rate per passenger (as well as the forecast impact of spend rates associated with enhancements to the duty free shopping experience that the private operator could undertake).

<sup>77</sup>Earnings Before Interest, Tax, Depreciation, and Interest (EBITDA).



**Table 8.6. Valuation drivers and potential for valuation enhancement.**

Value Driver	Potential for Value Enhancement
<ul style="list-style-type: none"> <li>▪ Aeronautical revenues               <ul style="list-style-type: none"> <li>– Landing fees</li> <li>– Terminal rentals</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Low potential – often subject to cap, regulation</li> <li>▪ Value comes from increased operations, maximum take-off weight</li> </ul>
<ul style="list-style-type: none"> <li>▪ Non-aeronautical revenues               <ul style="list-style-type: none"> <li>– Retail</li> <li>– Food/beverage</li> <li>– Duty free</li> <li>– Public parking</li> <li>– Rental cars</li> <li>– Commercial development</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Highest potential – opportunities for innovation</li> <li>▪ Promote airport user discretionary spending (duty free, retail, parking)</li> <li>▪ Negotiation of favorable business arrangements</li> <li>▪ Proactive commercial development</li> </ul>
<ul style="list-style-type: none"> <li>▪ Operation and maintenance expense               <ul style="list-style-type: none"> <li>– Staff</li> <li>– Utilities</li> <li>– Contract services</li> <li>– Equipment/material</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Limited-medium potential – usually within imposed constraints</li> <li>▪ Staff reductions usually subject to limitation</li> <li>▪ Opportunities for efficiency and productivity improvement</li> <li>▪ Outsourcing potential</li> <li>▪ Renegotiated supply contracts</li> </ul>

Table 8.7 illustrates that there are limits to increasing non-aeronautical concession revenues depending on the profile of the airport. For example, the operator of a small hub airport cannot be expected to develop a concession program on par with that of a major international gateway. Similarly, an airport with an older, less efficient terminal cannot provide the concession space needed to take full advantage of the market. Airports that have predominantly short-haul flights will realize lower passenger spend rates than airports with long-haul flights because passengers making long-haul trips tend to arrive sooner, spend more time in the terminal, and make more retail and food and beverage purchases for use or consumption during their trip.

Aeronautical revenues would often be considered as the area with the least potential for value enhancement because this

revenue category is regulated and, in the United States, covered by an airline lease and use agreement or the U.S.DOT Rates and Charges Policy (the Policy). The Policy requires that rates and charges levied on airlines for services and facilities at U.S. airports be “reasonable” and that airlines cannot be subjected to “unjust discrimination” in fees and operating conditions, unless otherwise agreed to by the airline. It also has required historical cost pricing for airfield fees. Any airline that is not a signatory to an agreement may challenge the fee under the Policy if the airline believes the rates imposed by the airport owner do not meet these requirements. However, under the APPP where aeronautical rates are subject to caps, there is the potential to increase aeronautical revenues by increasing traffic.

Operating expenses would generally have moderate potential at least in the short-term period; there may be operating

**Table 8.7. Factors affecting concession program demand and performance potential.**

Factor	Less Demand / Sales	More Demand / Sales
1 Terminal configuration	Multiple flows	Single flow
2 Average trip length	Short haul	Long haul
3 International versus domestic	Domestic	International
4 Passenger dwell time	Short	Long
5 Originating versus connecting	Connecting	Originating
6 Purpose of travel	Business	Leisure
7 Passenger demographics	Lower average income	High average income
8 Traffic peaks	A few, concentrated peaks	Traffic evenly distributed
9 Location of concession space	Indirect exposure to passenger flows	Direct exposure to passenger flows
10 Quantity of concession space	Constrained	Commercially optimized

Source: LeighFisher, *ACRP Report 54: Resource Manual for Airport In Terminal Concessions*, November 2011.

cost reductions that could be made, but airport privatization transactions often carry staffing level constraints, such as not abrogating labor agreements that would limit a private operator's flexibility. Another business plan metric, such as demand for janitorial service in the terminal, would vary somewhat with passenger levels but is more affected by changes in terminal space. For example, a 10% increase in passengers using a terminal may call for but a 2% increase in the number of janitors. A new terminal expansion that increases terminal space by a significant amount would likely need a significant expansion of janitorial staff.

Other key financial and business plan metrics include capital structure, leverage levels, and expected return on investment.

The largest value driver is passengers because the incremental cost to handle one passenger is a small fraction of the incremental revenues contributed by that passenger.

## 8.7 Risks and Mitigants

There can be measures taken to mitigate most of the risks to privatization strategies. From an airport owner's

perspective, some general guidelines for mitigating risk include the following:

- Develop a master plan and investment plan for the concession term
- Establish performance and quality of service standards
- Forbid the private operator from selling the lease for at least five years
- Make sure the risk/reward ratio is attractive and well-defined
- Contractually allocate risks between the government and the private sector
- Allow for efficient and reasonable infrastructure development requirements for which the users are willing to acknowledge and pay the costs
- Conduct a simple and transparent process for the bidding with clear evaluation criteria
- Carefully think through specifications for the contracts
- Clearly spell out rules for extending or renegotiating contracts, if any

Tables 8.8 to 8.11 summarize specific opportunities, key stakeholder concerns, and potential mitigating measures

**Table 8.8. Service contracts—stakeholder views, risks, and mitigants.**

Stakeholder	Opportunities	Risks/Concerns	Mitigating Measures
<i>Policy Makers</i>	<ul style="list-style-type: none"> <li>▪ Retain control over the airport assets (e.g., prices, CapEx, levels of service, noise mitigation, etc.)</li> <li>▪ Provide opportunity for operational efficiencies and cost reductions</li> </ul>	<ul style="list-style-type: none"> <li>▪ Loss of civil service jobs</li> <li>▪ Less control over performance and level of service</li> </ul>	<ul style="list-style-type: none"> <li>▪ Consider requiring contractor to hire airport employees</li> <li>▪ Include strong performance and service standards in contract</li> </ul>
<i>U.S. Airport Management</i>	<ul style="list-style-type: none"> <li>▪ Reduce airport costs for employee salaries and benefits</li> <li>▪ Allow airport management to focus on core and strategic issues</li> <li>▪ Retain airport oversight of contracts to ensure compliance with airport goals</li> <li>▪ De-politicize the provision of services (e.g., concessions)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Could involve organizational disruption (i.e., reassign or terminate existing employees)</li> <li>▪ Could encounter labor resistance</li> <li>▪ Quality of products and services and customer satisfaction</li> <li>▪ Level of capital investment and sufficiency of maintenance</li> </ul>	<ul style="list-style-type: none"> <li>▪ Plan in advance – avoid hiring full-time employees for this function</li> <li>▪ Keep employees advised of plans and potential for their employment by contractor</li> <li>▪ Provide for termination and take-back if performance standards are not met</li> <li>▪ Specify investment requirements and performance standards</li> </ul>
<i>Airlines</i>	<ul style="list-style-type: none"> <li>▪ Reduce airline costs to operate at the airport</li> <li>▪ Provide greater predictability and stability in rates</li> <li>▪ Ensure efficient airline operations</li> <li>▪ Provide opportunity for airline equipment maintenance or fuel system consortia</li> </ul>	<ul style="list-style-type: none"> <li>▪ Contractor meets stated operating and service standards</li> <li>▪ Service disruptions</li> </ul>	<ul style="list-style-type: none"> <li>▪ Negotiate detailed operating and performance standards in service contract</li> <li>▪ Make selection based on proposals, not lowest bid</li> <li>▪ Include strong indemnification provision</li> </ul>
<i>Federal Regulations</i>		<ul style="list-style-type: none"> <li>▪ Compliance with federal laws and regulations by owner and its contractors</li> </ul>	<ul style="list-style-type: none"> <li>▪ Monitor compliance</li> </ul>
<i>Private Contractors</i>	<ul style="list-style-type: none"> <li>▪ Make a profit</li> <li>▪ Increase depth and breadth of company</li> </ul>	<ul style="list-style-type: none"> <li>▪ Can be hard to monitor</li> <li>▪ Can be problems with service quality</li> </ul>	<ul style="list-style-type: none"> <li>▪ Negotiate performance-based contracts that hold contractors accountable for meeting specific quality service standards</li> </ul>
<i>Lenders</i>	▪ n.a.	▪ n.a.	▪ n.a.
<i>Investors</i>	▪ n.a.	▪ n.a.	▪ n.a.
<i>Rating Agencies</i>	<ul style="list-style-type: none"> <li>▪ Reduce operating expenses</li> <li>▪ Increase nonairline revenues</li> </ul>	<ul style="list-style-type: none"> <li>▪ New, untested technology and potential disruption to operations</li> </ul>	<ul style="list-style-type: none"> <li>▪ Avoid untested new technology</li> </ul>
<i>Labor</i>	<ul style="list-style-type: none"> <li>▪ Be hired by the private operator</li> </ul>	<ul style="list-style-type: none"> <li>▪ Protection of existing civil service jobs</li> <li>▪ Violation of collective bargaining agreements</li> </ul>	<ul style="list-style-type: none"> <li>▪ Work with airport management to minimize impact</li> <li>▪ Negotiate changes to agreements if possible</li> </ul>
<i>Passengers</i>	<ul style="list-style-type: none"> <li>▪ Improve customer service and the passenger experience for business and leisure travelers</li> <li>▪ Improve access to a wider variety of concession opportunities and amenities</li> </ul>	<ul style="list-style-type: none"> <li>▪ Reasonable pricing</li> <li>▪ Maintaining high levels of safety and security</li> </ul>	<ul style="list-style-type: none"> <li>▪ Retain owner approval rights over pricing</li> <li>▪ Establish price controls (e.g., “street pricing” for concessions)</li> </ul>

Table 8.9. Management contracts—stakeholder views, risks, and mitigants.

Stakeholder	Opportunities	Risks/Concerns	Mitigating Measures
<b>Policy Makers</b>	<ul style="list-style-type: none"> <li>▪ Provide better service at the same or reduced cost</li> <li>▪ Attract new airline service and encourage economic development by reducing airline costs through increased nonairline revenues and reduced operating expenses</li> <li>▪ Improve customer service and quality</li> <li>▪ Improve the expertise and diversity of airport staff</li> <li>▪ Improve the airport's long-term competitive position</li> <li>▪ Retain a significant degree of control over the airport assets (e.g., prices, CapEx, levels of service, noise mitigation, etc.)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Operator focuses on maximizing its fee at the expense of customer service</li> <li>▪ Ensure fair and equitable treatment of existing airport employees</li> <li>▪ Involves considerable time and effort for bidding process</li> <li>▪ Delegates a significant degree of control over airport operations</li> </ul>	<ul style="list-style-type: none"> <li>▪ Tie compensation to each goal not just reduction in airline costs</li> <li>▪ Consider contracting with multiple firms specializing in each area in which improvement was targeted</li> <li>▪ Require private operator to offer comparable employment to current airport employees and/or require that the owner offer alternative jobs to those employees who do not go to work for the operator</li> <li>▪ Invest time upfront for first transaction so renewal or rebidding takes less time</li> <li>▪ Retain controls over key functions (police, fire, noise mitigation)</li> <li>▪ Include performance oversight standards for the private operator in the lease</li> <li>▪ Limit term to 10 or 15 years, which also is needed to meet "qualified management contract" test under IRS regulations</li> </ul>
<b>U.S. Airport Management</b>	<ul style="list-style-type: none"> <li>▪ Provide greater incentives for management and employees to perform better</li> <li>▪ Ability to maximize efficiency and improve performance based upon private operator's work at other airports</li> <li>▪ Might provide relief from cumbersome public procurement rules and social policy mandates and permit airport to operate more like a business than a unit of government</li> <li>▪ Can streamline and improve certain processes</li> <li>▪ Airport owner retains control over capital development and other key decisions</li> </ul>	<ul style="list-style-type: none"> <li>▪ Could involve organizational disruption (i.e., reassign or terminate existing employees)</li> <li>▪ Difficult to truly measure performance for the purpose of justifying compensation</li> <li>▪ Tracking contract compliance can be a time consuming and substantial undertaking for the airport owner</li> </ul>	<ul style="list-style-type: none"> <li>▪ Require operator to offer employment to airport employees</li> <li>▪ Assess effectiveness and economics of contracting with multiple firms specializing in each area in which improvement is targeted (e.g., ARFF, parking, fueling, fixed base operations)</li> <li>▪ Use metrics to gauge performance that are transparent and easily measurable and tie compensation to each goal the owner is trying to achieve (e.g., lower costs, enhanced nonairline revenues, improved customer service, new air service)</li> </ul>
<b>Airlines</b>	<ul style="list-style-type: none"> <li>▪ Reduce airline costs to operate at the airport</li> <li>▪ Maintain capital project approval ("majority-in-interest") rights</li> <li>▪ Provide greater predictability and stability in rates</li> <li>▪ Ensure efficient airline operations</li> <li>▪ Ensure that any monies generated on airport remain in the airport system and are not diverted to other purposes</li> <li>▪ Provide opportunity for airline terminal equipment maintenance and fuel system consortia</li> </ul>	<ul style="list-style-type: none"> <li>▪ Ensuring contractor meets stated operating and performance standards</li> <li>▪ Once initial efficiencies are attained, it becomes increasingly difficult to attain further improvements and realize the full value of the management fee</li> <li>▪ Control private operator's management fees and limit airport revenue taken off the airport</li> </ul>	<ul style="list-style-type: none"> <li>▪ Negotiate detailed operating and performance standards</li> <li>▪ Rebid the contract periodically</li> </ul>
<b>Federal Regulations</b>		<ul style="list-style-type: none"> <li>▪ Ensuring airport and its operator abide by and comply with federal laws and regulations</li> </ul>	<ul style="list-style-type: none"> <li>▪ Include terms requiring the private entity to conduct its activities consistent with the grant assurances and other federal obligations imposed on the owner and that the management agreement itself be subordinate to the grant assurances</li> <li>▪ Execute separate agreements for airport management functions and aeronautical activities to be conducted by the private entity</li> </ul>
<b>Private Contractors</b>	<ul style="list-style-type: none"> <li>▪ Make a profit</li> <li>▪ Position the contractor to transition to full privatization at the airport</li> <li>▪ Provide opportunity to sell other services, such as planning and construction management at the airport</li> <li>▪ Establish good relationships with primary tenants</li> </ul>	<ul style="list-style-type: none"> <li>▪ For airport-wide contracts, limited opportunity to earn good returns</li> <li>▪ Diverts management attention for other more profitable ventures</li> </ul>	<ul style="list-style-type: none"> <li>▪ Strong performance on a high-profile project may influence the chances for subsequent business</li> <li>▪ Gain U.S. experience that would position the contractor well for full privatization opportunities elsewhere in the U.S.</li> </ul>
<b>Lenders</b>	▪ n.a.	▪ n.a.	▪ n.a.
<b>Investors</b>	▪ n.a.	▪ n.a.	▪ n.a.
<b>Rating Agencies</b>	<ul style="list-style-type: none"> <li>▪ Reduce operating expenses</li> <li>▪ Increase nonairline revenues</li> <li>▪ Enhance management expertise</li> </ul>	<ul style="list-style-type: none"> <li>▪ Transition risk</li> </ul>	<ul style="list-style-type: none"> <li>▪ Hire operator with good reputation and proven experience</li> <li>▪ Allow for ramp up time</li> </ul>

(continued on next page)

Table 8.9. (Continued).

Stakeholder	Opportunities	Risks/Concerns	Mitigating Measures
<i>Labor</i>	<ul style="list-style-type: none"> <li>▪ Be hired by the private operator</li> <li>▪ Learn specialized skills from national or global company</li> </ul>	<ul style="list-style-type: none"> <li>▪ Protect existing civil service jobs</li>   <li>▪ Violation of collective bargaining agreements</li> </ul>	<ul style="list-style-type: none"> <li>▪ Require private operator to offer comparable employment to current airport employees and/or require that the owner offer alternative jobs to those employees who do not go to work for the operator</li> <li>▪ Require operator to agree to appropriate procedures to protect the rights of employees to organize to engage in collective bargaining</li> </ul>
<i>Passengers</i>	<ul style="list-style-type: none"> <li>▪ Improve customer service and the passenger experience for business and leisure travelers</li> <li>▪ Improve access to a wider variety of concession opportunities and other amenities</li> </ul>	<ul style="list-style-type: none"> <li>▪ Reasonable pricing</li> <li>▪ Maintaining high levels of safety and security</li> </ul>	<ul style="list-style-type: none"> <li>▪ Retain approval rights on all rate increases</li> <li>▪ Include operating and performance standards in lease agreement with private operator</li> <li>▪ Conduct quality of service monitoring</li> </ul>

Table 8.10. Developer financing/operation—stakeholder views, risks, and mitigants.

Stakeholder	Opportunities	Risks/Concerns	Mitigating Measures
<i>Policy Makers</i>	<ul style="list-style-type: none"> <li>▪ Retain some control over most airport assets</li> <li>▪ Increase operational efficiencies and revenue enhancements</li> <li>▪ Preserve financing capacity</li> <li>▪ Reduce reliance on municipal debt</li> <li>▪ Attract private financing</li> <li>▪ Transfer financial risk exposure for cost overruns, delays, and debt repayment to the private sector</li> <li>▪ Deliver a functional facility on time and on budget</li> <li>▪ Improve service quality</li> </ul>	<ul style="list-style-type: none"> <li>▪ Ensure fair and equitable treatment of existing airport employees</li> <li>▪ Could involve buyouts and compensation for existing public workers</li> <li>▪ Requires considerable upfront planning, time, and expense</li>   <li>▪ Loss of control over pricing, capital investments, levels of service and maintenance</li>   <li>▪ Loss of control over the site and the flexibility to respond to changing market conditions</li>   <li>▪ Potential need to repay federal grants</li>   <li>▪ Ensure a smooth transition from public to private management in a timely manner</li> <li>▪ Involves long-term risk if the project encounters financial problems, especially under LLC model</li> </ul>	<ul style="list-style-type: none"> <li>▪ Require private operator to offer comparable employment to current airport employees and/or require that the owner offer alternative jobs to those employees who do not go to work for the operator</li>   <li>▪ Include price controls, capital investment requirements, performance and maintenance standards</li> <li>▪ Maintain control over key services such as terminal concessions (e.g., Boston) or terminal advertising (e.g., New York)</li> <li>▪ Include provisions allowing for the recapture of underutilized space (see Boston Terminal A case study)</li> <li>▪ Include provisions allowing for redevelopment of the site subject to certain conditions and repayment</li> <li>▪ Replace AIP-funded assets in kind, coordinate with the FAA early</li> <li>▪ Have a good transition plan in place</li>   <li>▪ Include acceleration clauses in event of default</li> <li>▪ Require GMP construction contract supported by performance bonds</li> <li>▪ Require completion within set time period</li> <li>▪ Require equity investment</li> <li>▪ Require bond insurance</li> <li>▪ Include default recapture language in agreements</li> </ul>
<i>U.S. Airport Management</i>	<ul style="list-style-type: none"> <li>▪ Preserve public capital for those areas where public funding is the only alternative</li> <li>▪ Minimize construction risk and management oversight</li> <li>▪ Apply private sector techniques to accelerate project delivery and reduce construction costs</li> <li>▪ Reduce operating expenses and increase operational efficiencies due to (a) avoidance of public procurement processes and (b) private sector motivations and incentives</li> <li>▪ Reduce operational responsibilities</li> <li>▪ Permit airport management to focus on other strategic issues and assets</li> </ul>	<ul style="list-style-type: none"> <li>▪ Involves considerable upfront planning, time, and expense</li> <li>▪ Requires that the project have a revenue stream to repay the debt</li> <li>▪ Less airport control over the project and delivery of quality facility</li> </ul>	<ul style="list-style-type: none"> <li>▪ Has potential to deliver project faster</li>   <li>▪ Use for projects that have revenue stream</li>   <li>▪ Require developer construct project to airport's specifications</li> <li>▪ Negotiate clear, well-understood agreements, including a development agreement, lease agreement, and GMP contract</li> <li>▪ Invoke a shared understanding of the goals of the project and familiarity with the underlying contractual documents</li> <li>▪ Have regular communication among the key stakeholders</li> <li>▪ Include incentives for achieving goals combined with penalties for failure to perform</li> </ul>

Table 8.10. (Continued).

Stakeholder	Opportunities	Risks/Concerns	Mitigating Measures
		<ul style="list-style-type: none"> <li>▪ Loss of control over future capacity expansion and flexibility to change land uses over period of lease</li> <li>▪ Less control of facility utilization and management</li>   <li>▪ Less control over types of activities and quality and appearance</li> <li>▪ Potential competition with airport facilities</li> <li>▪ Loss of key revenue streams under parking and cargo privatization</li> <li>▪ Could involve organizational disruption and need to reassign or terminate existing employees</li> <li>▪ Need to repay the Federal government for the value of grant-funded capital improvements</li> <li>▪ Bond indenture constraints</li> <li>▪ Potential impact on tax status of outstanding bonds</li> <li>▪ Loss of control in event of default</li> </ul>	<ul style="list-style-type: none"> <li>▪ Develop design guidelines to (1) document the minimum acceptable standards, (2) address review and approval of plans, specifications, schedule, costs, and change orders, and (3) specify materials standards, sizing requirements, sustainability, and concession space</li> <li>▪ Include provisions allowing for redevelopment of the site subject to certain conditions and repayment</li> <li>▪ Include limits on uses and require conformance with airport quality control standards</li> <li>▪ Include provisions allowing for the recapture of underutilized space (see Boston Terminal A case study)</li> <li>▪ Include provision to relocate all operations to a qualifying replacement premise on airport (see BOS Terminal A)</li> <li>▪ Include performance oversight standards for the developer</li> <li>▪ Limit uses under agreement</li>   <li>▪ Retain control of and revenues from terminal concessions</li> <li>▪ Require private operator to offer comparable employment to current airport employees</li>   <li>▪ Require developer to replace AIP-funded assets in kind</li>   <li>▪ Get guidance from bond counsel on ways to protect tax status and include in documents</li>   <li>▪ Design lease to fit the parameters of a “true” lease as opposed to a “financing” lease if tax-exempt financing used</li> </ul>
<i>Airlines</i>	<ul style="list-style-type: none"> <li>▪ Reduce airline costs and increase operational efficiencies by avoiding public procurement processes and by private sector motivations and incentives</li> <li>▪ Reduce airline costs to operate at the airport</li> <li>▪ Provide greater predictability and stability in rates</li> </ul>	<ul style="list-style-type: none"> <li>▪ Ensure developer meets stated operating standards</li> <li>▪ Ensure efficient airline operations</li> <li>▪ Predictability and stability in rates if the airline is not the developer</li> </ul>	<ul style="list-style-type: none"> <li>▪ Include strong operating and service performance standards in the lease with the private operator</li> </ul>
<i>Federal Regulations</i>		<ul style="list-style-type: none"> <li>▪ Ensure airports abide by and comply with federal laws and regulations, in particular the self-sustaining assurance to insure the payments to the private developer do not exceed the fair and reasonable value of its services or otherwise fail to comply with the revenue use policy</li> <li>▪ Loss of control over future capacity expansion</li> </ul>	<ul style="list-style-type: none"> <li>▪ Include safeguards in the lease to preserve the owner’s control over the actions of the operator that might affect compliance with AIP grant and PFC assurances</li>   <li>▪ Include provisions allowing for redevelopment of the site subject to certain conditions and repayment</li> </ul>
<i>Private Developers</i>	<ul style="list-style-type: none"> <li>▪ Earn profit on development fees and ongoing operation of facility</li> <li>▪ Gain U.S. experience to position the company well for full privatization opportunities in the future</li> <li>▪ Establish good relationships with potential tenants</li> </ul>	<ul style="list-style-type: none"> <li>▪ Lack of clear and transparent solicitation process</li> <li>▪ Obligations to finance ongoing CapEx</li>   <li>▪ Potential that project is not implemented after spending considerable time and effort on solicitation</li> <li>▪ Cost and limited availability of bond insurance</li> <li>▪ Potential company is not selected and spends considerable time and effort</li> <li>▪ Potential that the project turns out to be unsuccessful and affects the developer’s reputation</li> </ul>	<ul style="list-style-type: none"> <li>▪ Conduct transparent process on a credible timetable</li> <li>▪ Provide clear project specifications and ongoing responsibilities</li> <li>▪ Vet political, legal, economic, and financial feasibility of the project before soliciting interest</li> <li>▪ Consider backstopping the project in the early years</li> <li>▪ Provide clear selection criteria</li>   <li>▪ Select developer that has strong experience with similar projects</li> </ul>

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Table 8.10. (Continued).

Stakeholder	Opportunities	Risks/Concerns	Mitigating Measures
<i>Lenders</i>	<ul style="list-style-type: none"> <li>▪ Lend in a sector with substantial growth opportunity</li> </ul>	<ul style="list-style-type: none"> <li>▪ Nonrecourse financing entails a risk if the developer is an LLC or has limited assets to guarantee the investment</li> </ul>	<ul style="list-style-type: none"> <li>▪ Require level annual principal and interest payments and reserves</li> </ul>
<i>Investors</i>	<ul style="list-style-type: none"> <li>▪ Invest in a sector with substantial growth opportunity</li> </ul>	<ul style="list-style-type: none"> <li>▪ Risk of bankruptcy and loss of investment</li> </ul>	<ul style="list-style-type: none"> <li>▪ Select developer that has strong experience with similar projects</li> <li>▪ Require material levels of direct equity investment or guarantees from developer</li> </ul>
<i>Rating Agencies</i>	<ul style="list-style-type: none"> <li>▪ Expand capacity to accommodate higher levels of traffic</li> </ul>	<ul style="list-style-type: none"> <li>▪ Potential for project to generate adequate cash flow to pay bondholders</li> <li>▪ Completion and delay risk</li> <li>▪ Traffic risk</li> <li>▪ Characterization of lease as a “financing” lease vs. “true” lease</li> <li>▪ Obsolescence risk</li> <li>▪ Debt structure risk</li> <li>▪ Loss of key revenue streams to owner under parking and cargo privatization</li> </ul>	<ul style="list-style-type: none"> <li>▪ Select developer that has strong experience with similar projects</li> <li>▪ Require material levels of direct equity investment or guarantees combined with covenants to retain adequate capitalization (liquidity and reserves)</li> <li>▪ Require parent support or guarantee</li> <li>▪ Select developer with history of support for investments</li> <li>▪ Mandate minimum ownership and change of control covenants through life of debt</li> <li>▪ Require GMP or contractor retentions, penalty payments, and liquidated damages</li> <li>▪ Hire experienced developer who can attract service</li> <li>▪ Draft legal documents properly to avoid this characterization</li> <li>▪ Require continued capital investment in facility over life of lease</li> <li>▪ Require level annual principal and interest payments and reserves</li> <li>▪ Maintain strong debt service coverage on outstanding revenue bonds</li> </ul>
<i>Labor</i>	<ul style="list-style-type: none"> <li>▪ Opportunity to be hired by the private operator with higher pay</li> </ul>	<ul style="list-style-type: none"> <li>▪ Ensure no decrease in salaries and benefits</li> <li>▪ Retain years-of-service credited towards pension requirements</li> <li>▪ Maintain the stability and protections otherwise provided by government jobs</li> </ul>	<ul style="list-style-type: none"> <li>▪ Require offers of employment by developer under substantially similar terms and conditions as government</li> <li>▪ Require operator to provide retirement program (e.g., 401(k) or defined pension plan)</li> <li>▪ Prohibit abrogation of existing collective bargaining agreements</li> </ul>
<i>Passengers</i>	<ul style="list-style-type: none"> <li>▪ Improve customer service and the passenger experience for business and leisure travelers</li> <li>▪ Improve access to a wider variety of concession opportunities and other amenities</li> </ul>	<ul style="list-style-type: none"> <li>▪ Reasonable pricing</li> <li>▪ Maintaining high levels of safety and security</li> </ul>	<ul style="list-style-type: none"> <li>▪ Set reasonable conditions on rate increases</li> <li>▪ Include operating and performance standards in lease agreement with private operator</li> <li>▪ Conduct quality of service monitoring to ensure that airport operators do not degrade service standards as a means of reducing costs and increasing profit</li> </ul>

**Table 8.11. Full privatization—stakeholder views, risks, and mitigants.**

Stakeholder	Opportunities	Risks/Concerns	Mitigating Measures
<p><i>Policy Makers</i></p>	<ul style="list-style-type: none"> <li>▪ Raise money to fund municipal budget deficits, pension deficits, infrastructure development, and other general purpose needs</li> <li>▪ Reduce public debt</li> <li>▪ Encourage economic development</li> <li>▪ Allow for higher infrastructure investment in airport facilities by providing access to private capital for airport improvements and development</li> <li>▪ Transfer financial risks to private sector</li> <li>▪ Increase operational efficiencies and revenue enhancements</li> <li>▪ Increase passenger traffic and air service to boost local employment and visitor spending</li> <li>▪ Shrink the size of government and promote ideological interest in increased private sector participation</li> <li>▪ Focus on core services of government (public safety, education, etc.)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Requires considerable upfront planning, time, and expense</li> <li>▪ Retaining high level service and operating standards</li> <li>▪ Loss of a significant degree of control over the airport assets</li> <li>▪ Fair and equitable treatment of existing airport employees</li> <li>▪ Potential need to repay federal grants and therefore reduce the net cash payout</li> <li>▪ Exposure to residual risks and liabilities from the process</li> <li>▪ Protecting the reasonable interests of current and future airlines</li> <li>▪ Ensuring a smooth transition from public to private management in a timely manner</li> <li>▪ Requests to cancel concession contracts</li> <li>▪ Lack of slots under the APPP</li> <li>▪ Reduced ability to maximize value of airport as economic and transportation asset</li> <li>▪ Responsiveness of private operator to community needs and concerns</li> <li>▪ Environmental stewardship</li> </ul>	<ul style="list-style-type: none"> <li>▪ Consider risks and reward before deploying too many resources</li> <li>▪ Include strong operating and service performance standards in the lease with the private operator</li> <li>▪ Retain controls over key functions (police, fire, noise mitigation)</li> <li>▪ Require operator to develop annual capital asset maintenance plan, capital improvement program report, and 5-year capital improvement program for owner’s approval</li> <li>▪ Require private operator to offer comparable employment to current airport employees and/or require that the owner offer alternative jobs to those employees who do not go to work for the operator</li> <li>▪ Require operator to maintain wages at levels comparable to those of other government employees</li> <li>▪ Require operator to agree to appropriate procedures to protect the rights of employees to organize to engage in collective bargaining</li> <li>▪ Coordinate early with FAA headquarters on potential exposure and means to avoid repayment</li> <li>▪ Form a team with technical advisors that have experience with complex legal, financial, operational, and regulatory issues</li> <li>▪ Make sure the goals are always transparent and well-articulated to help minimize resistance to the transaction</li> <li>▪ Get key stakeholders on board early (including labor and airlines) to maximize the potential for success</li> <li>▪ Get strong political commitment to achieve privatization</li> <li>▪ Develop and implement a coherent and integrated strategy with reduced political interference and increased transparency</li> <li>▪ Require winning bidder to post earnest money</li> <li>▪ Negotiate a long-term airline agreement with the carriers</li> <li>▪ Have a good transition plan in place</li> <li>▪ Carefully manage public perception</li> <li>▪ Forbid the private operator from selling the lease for 5 years</li> <li>▪ Align the interests of the private company with the appropriate incentives</li> <li>▪ Consider opportunity while slots remain available</li> <li>▪ Align the interests of the government and operator</li> <li>▪ Establish an airport advisory commission and require the operator to meet with the commission on a regular basis (see SWF)</li> <li>▪ Include strong environmental compliance provisions and enforcement penalties in lease</li> <li>▪ Maintain control of noise mitigation</li> </ul>
<p><i>U.S. Airport Management</i></p>	<ul style="list-style-type: none"> <li>▪ Provide an opportunity for the government to cash-in on a government-owned asset (minority view)</li> <li>▪ Provide relief from cumbersome public procurement rules and social policy mandates to operate airports more like a business than a unit of government</li> </ul>	<ul style="list-style-type: none"> <li>▪ Concern that elected officials might sell or lease airports for the wrong reason</li> <li>▪ Provide for the best interests of the tenants, passengers, and community over the long-term</li> <li>▪ Loss of management jobs</li> <li>▪ Concern that 65% airline approval entails too many concessions</li> </ul>	<ul style="list-style-type: none"> <li>▪ Conduct workshops with elected officials on the pros and cons of this model</li> <li>▪ Include strong operating, service, and CapEx performance standards in the lease with the private operator</li> <li>▪ Consider full privatization outside APPP</li> </ul>

(continued on next page)

Table 8.11. (Continued).

Stakeholder	Opportunities	Risks/Concerns	Mitigating Measures
		<ul style="list-style-type: none"> <li>▪ Lack of access to tax-exempt debt by private operator driving up the cost of capital</li> <li>▪ Ability to shift ultimate risk to operator and likelihood of continued involvement and responsibility</li> <li>▪ No guarantee that the private airport operator will achieve financial success, retain interest in the business, or be successful in its execution</li> </ul>	<ul style="list-style-type: none"> <li>▪ Allow for short-term financing to permit the operator to exploit the low end of the yield curve</li> <li>▪ Require operator to invest a material level of equity</li> <li>▪ Align the interests of the private company with the appropriate incentives</li> </ul>
<i>Airlines</i>	<ul style="list-style-type: none"> <li>▪ Provide greater predictability and stability in rates</li> <li>▪ Best suited for airports that have less operational independence and more challenging governance structures</li> <li>▪ Prefer deal structured with annual payments where all parties benefit if the airport grows</li> <li>▪ Shift economic risk from airlines to operator</li> </ul>	<ul style="list-style-type: none"> <li>▪ Controlling and minimizing increases in and greater predictability of airport charges</li> <li>▪ Efficient airline operations</li> <li>▪ Certainty regarding the availability of gates and other facilities for their operations</li> <li>▪ Drive for profit maximization will come at the expense of airline profits and consumer welfare</li> <li>▪ Abuse of monopoly position</li> <li>▪ Reduced investment in aeronautical infrastructure and priority to invest in commercial revenue infrastructure</li> </ul>	<ul style="list-style-type: none"> <li>▪ Limit future airline rate increases to inflation adjustments</li> <li>▪ Grant the airlines approval rights for capital improvement costs to be included in airline rates</li> <li>▪ Include strong operating and service performance standards in the lease with the private operator</li> <li>▪ Negotiate gate and space protocols in airline agreement</li> <li>▪ Require operator to make capital expenditures to maintain and develop the airport</li> <li>▪ Require guarantees that the airport will be run in a customer service friendly fashion, with a particular focus on pricing controls</li> <li>▪ Give the airlines sign off rights on the bidders' qualifications</li> <li>▪ Require operator to provide annual capital asset maintenance plan, capital improvement program report, and five-year capital improvement program to the airlines</li> </ul>
<i>Federal Regulations</i>		<ul style="list-style-type: none"> <li>▪ Compliance with federal laws and regulations, including grant assurances, environmental regulations, revenue use policy, and the rates and charges policy</li> <li>▪ No revenue diversion except as permitted under the APPP<sup>78</sup> and determining a reasonable rate of return</li> <li>▪ Satisfying the 9 statutory conditions under the APPP</li> <li>▪ Justifying exemptions granted under the APPP</li> <li>▪ May be subject to investigation by the Committee on Foreign Investment in the United States (CFIUS)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Monitor airports to ensure they comply with federal laws and regulations</li> <li>▪ Issue order or guidance on specific requirements and terms</li> <li>▪ Establish rules for reasonable rate of return</li> <li>▪ Encourage potential APPP applicants to meet with FAA staff early and often</li> <li>▪ Confer with applicants and Congressional representatives</li> </ul>
<i>Private Airport Operators</i>	<ul style="list-style-type: none"> <li>▪ Increase efficiencies from being able to manage all employees and do more contracting out</li> <li>▪ Engage in procurement faster and more efficiently (for operations and CapEx)</li> <li>▪ Exploit nonairline commercial opportunities</li> <li>▪ Maximize utilization of terminal space, including new technology to move passengers more efficiently and minimize the amount of space needed</li> <li>▪ Leverage experience and expertise gained from international airport privatization</li> <li>▪ Gain U.S. experience that would position the company well for similar opportunities in the future</li> <li>▪ Private operators have more flexibility to incentivize employees (e.g.,</li> </ul>	<ul style="list-style-type: none"> <li>▪ Complying with the owner's M/WBE and related ordinances</li> <li>▪ Retaining existing public service employees and collective bargaining agreements</li> <li>▪ Limitation on aeronautical charges, which could reduce the flexibility of the operator to set charges, and hinder its ability to respond to specific new opportunities</li> <li>▪ Non-negotiable and restrictive airline use and lease agreement</li> <li>▪ Giving airlines a veto right over new assets (which may be used in practice to inhibit competition, e.g. in the case of facilities for low-cost carriers)</li> <li>▪ Unfunded government mandates and take-backs</li> </ul>	<ul style="list-style-type: none"> <li>▪ Minimize requirements imposed on lessee</li> <li>▪ Give employees the option to remain with the government</li> <li>▪ Allow operator to negotiate future labor agreements</li> <li>▪ Limited due to restrictions in APPP</li> <li>▪ Consider full privatization outside APPP</li> <li>▪ Confer with potential private operators before concluding airline lease negotiations</li> <li>▪ Negotiate exclusions in MII provisions in airline agreement</li> <li>▪ Provide ARFF and security activities paid for from a fund set aside from lease award proceeds (see Midway)</li> </ul>

<sup>78</sup>The APPP permits U.S.DOT to grant an exemption from the prohibition on revenue diversion “to the extent necessary to permit the purchaser or lessee to earn compensation from the operations of the airport.” FAA guidance indicates that a private operator acting outside of the APPP would be subject to all of the grant assurances, presumably including the prohibition on revenue diversion. However, it is uncertain whether FAA would permit a private operator in such circumstances to derive a rate of return on its investment in the airport.



Table 8.11. (Continued).

Stakeholder	Opportunities	Risks/Concerns	Mitigating Measures
	<ul style="list-style-type: none"> <li>▪ bonuses, succession programs, and training), can use employees for a wider range of disciplines, and are not burdened by public processes</li> </ul>	<ul style="list-style-type: none"> <li>▪ Financial return may be limited due to FAA provided exemption from the revenue use assurance, under the APPP</li> <li>▪ Access to AIP grants</li>   <li>▪ Inability to levy a PFC except under the APPP</li> <li>▪ Significant benefit to government ownership under the U.S. regime</li> <li>▪ Burden of the grant assurances and other obligations on airport sponsors</li>   <li>▪ Potential responsibility for ensuring Constitutional protections</li> </ul>	<ul style="list-style-type: none"> <li>▪ Consider the APPP where entitlement grants and discretionary grants remain available (at 70% federal share for discretionary)</li> <li>▪ Private operators outside the APPP may be eligible for discretionary grants if the airport is a reliever airport or receives 2,500 annual passenger boardings</li> <li>▪ Privatization outside the APPP may permit the imposition of charges on passengers</li> <li>▪ None</li>   <li>▪ Include requirements in lease that operator comply with grant assurances with strong penalties</li> <li>▪ Limited</li> </ul>
<i>Lenders</i>	<ul style="list-style-type: none"> <li>▪ Invest in sector with historically strong cash flow generation and resiliency</li> <li>▪ Be appropriately rewarded (via an interest rate margin) for the risk to provide debt financing</li> </ul>	<ul style="list-style-type: none"> <li>▪ Stability of the cash flows generated by the airport</li>   <li>▪ Security in the case of default</li> <li>▪ High leverage, i.e. proportion of the airport's enterprise value funded by debt rather than equity</li> <li>▪ Subordination of the debt, i.e., if the operator has existing debt that ranks higher in priority for claims on available funds</li> <li>▪ Refinancing risk especially if the loan provided has a short maturity</li> </ul>	<ul style="list-style-type: none"> <li>▪ Select operator with strong credentials</li> <li>▪ Be comfortable with risk/reward</li> <li>▪ Invest in airports that have limited exposure to traffic risk</li> <li>▪ Require cost-based ratemaking</li> <li>▪ Obtain influence on operating, commercial, financial, and strategic decision making</li> <li>▪ Negotiate priority treatment</li> <li>▪ Require equity investment by operator</li>   <li>▪ Negotiate parity debt or higher returns</li>   <li>▪ Provide a structure allowing for partial or full deferral of principal</li> </ul>
<i>Investors</i>	<ul style="list-style-type: none"> <li>▪ Secure long-term investment with strong competitive position -- returns have been profitable in most cases</li> <li>▪ Secure strong cash flows</li> <li>▪ Capture opportunities for commercial revenue growth</li> <li>▪ Achieve savings from operational efficiencies</li> <li>▪ Realize inflation adjusted returns</li> <li>▪ Acquire long-term growth prospects</li> </ul>	<ul style="list-style-type: none"> <li>▪ Time and cost of bid process</li>   <li>▪ Earnings quality</li>   <li>▪ Traffic risks</li> <li>▪ Likely investment required</li> </ul>	<ul style="list-style-type: none"> <li>▪ Conduct transparent process for the transaction</li> <li>▪ Provide clear and credible timetable for the process</li> <li>▪ Minimize cost of participating, especially in the initial round</li> <li>▪ Provide access to relevant data to conduct due diligence</li> <li>▪ Access to management team</li> <li>▪ Help promote air service</li> <li>▪ Have reasonable expectations of the value of the transaction</li> </ul>
<i>Rating Agencies</i>	<ul style="list-style-type: none"> <li>▪ Increase traffic</li> <li>▪ Increase non-aeronautical revenues</li> <li>▪ Reduce operating expenses</li> </ul>	<ul style="list-style-type: none"> <li>▪ Operator experience and management practices</li> <li>▪ Liquidity levels</li> <li>▪ CapEx requirements and expected debt financing needed</li>   <li>▪ Capital structure, debt maturities</li> <li>▪ Revenue diversity and stability</li> <li>▪ Ability to raise rates</li> <li>▪ Operating restrictions</li>   <li>▪ Dividend policy and history of shareholder distributions</li> <li>▪ Ability to withstand stress tests</li> <li>▪ Need to optimize equity returns may result in a capital structure that is inconsistent with higher credit quality</li> </ul>	<ul style="list-style-type: none"> <li>▪ Award lease to strong and experienced operator/lessee</li> <li>▪ Limited</li> <li>▪ Mandate reasonable CapEx requirements and allow operator to maximize the utilization of existing facilities first</li> <li>▪ Require equity investment</li> <li>▪ Limited at smaller airports</li> <li>▪ Set reasonable conditions on rate increases</li> <li>▪ Minimize operating conditions within reasonable performance standards</li> <li>▪ Select operator that has strong experience</li>   <li>▪ Require strong legal provisions</li> <li>▪ None</li> </ul>

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Table 8.11. (Continued).

Stakeholder	Opportunities	Risks/Concerns	Mitigating Measures
<i>Labor</i>	<ul style="list-style-type: none"> <li>▪ Work for a private operator with no change in pay/benefits and with incentive compensation and career development opportunities by working for a company with a global network</li> <li>▪ Fund pension liabilities and infrastructure investments from lease payments</li> </ul>	<ul style="list-style-type: none"> <li>▪ Stability and protections provided by government jobs</li> <li>▪ Loss of jobs and collective bargaining rights<sup>79</sup></li> <li>▪ No decrease in salaries and benefits</li> <li>▪ Years-of-service credited towards pension requirements</li> </ul>	<ul style="list-style-type: none"> <li>▪ Require offers of employment by developer under substantially similar terms and conditions as government</li> <li>▪ Prohibit abrogation of existing collective bargaining agreements</li> <li>▪ Require Project Labor Agreements for large capital projects</li> <li>▪ Protect workers from wage and benefit reductions</li> <li>▪ Require operator to provide retirement program (e.g., 401(k) or defined pension plan)</li> </ul>
<i>Passengers</i>	<ul style="list-style-type: none"> <li>▪ Improve customer service and the passenger experience for both business and leisure travelers</li> <li>▪ Improve access to a wider variety of concession opportunities and other amenities</li> </ul>	<ul style="list-style-type: none"> <li>▪ Increases in pricing for parking, concessions, etc.</li> <li>▪ Maintaining high levels of safety and security</li> <li>▪ Private operator profit maximization at the expense of consumer welfare and satisfaction</li> <li>▪ Diminished community control</li> </ul>	<ul style="list-style-type: none"> <li>▪ Set reasonable conditions on rate increases</li> <li>▪ Include operating and performance standards in lease agreement with private operator</li> <li>▪ Conduct quality of service monitoring to ensure that airport operators do not degrade service standards as a means of reducing costs and increasing profit</li> <li>▪ Retain controls over noise mitigation</li> </ul>

to stakeholder concerns for each privatization model. The tables are not checklists, but qualitative guidance in assessing the attributes present in a model and are only part of the evaluation process. As noted earlier, the U.S.DOT/FAA, in its capacity as regulator of airports, is concerned with airport compliance with applicable federal laws, regulations, and policy. We have attempted to summarize relevant aspects of such laws, regulations, and policies in the tables above in terms of federal regulatory risks for each model and provide potential mitigants to be considered by parties to ensure compliance. These are not the views of the U.S.DOT/FAA.

In some cases, the concerns expressed by stakeholders represent unintended consequences resulting from attempts to mollify other stakeholders. Such unintended consequences are clearly undesirable, and a major priority should be to minimize the likelihood of such effects to the extent possible and reasonable. In the end, tradeoffs will be required.

It should also be noted that *the absence of mitigating measures is also a concern*, which is indicated by no comment on the summary tables.

## 8.8 Evaluation Checklist

The final step is to evaluate the appropriate privatization models against more specific owner criteria. The privatization initiative should only proceed if there is a sound economic, financial, and legal basis with a high probability of success and

<sup>79</sup>Under the APPP statute, any collective bargaining agreements covering airport employees that are in effect on the date of the sale or lease of the airport cannot be abrogated by the sale or lease.

support from key stakeholders. From an airport owner's perspective, the privatization models can be evaluated in terms of issues and opportunities regarding (1) governance, (2) regulatory, (3) legal, (4) financial, (5) economic, (6) commercial, (7) labor, (8) customer service, and (9) implementation. In this context, these terms mean:

1. **Governance** refers to the degree of policy decision making required or control retained by the airport owner.
2. **Regulatory** refers to rules that are established by federal policies such as grant assurances, Surplus Property Act deed restrictions, Airport Security Program, CFIUS, prohibition on revenue diversion, Policy Regarding Airport Rates and Charges, APPP conditions, IRS regulations, etc.
3. **Legal** refers to external constraints that are established by laws, labor contracts, and financial commitments made to various parties such as bondholders and trustees.
4. **Financial** refers to the responsibility for staffing, management, and capital improvements as well as paying operating expenses and debt service, and includes the potential for revenue increases and/or cost reductions.

Table 8.12 summarizes the *financial responsibilities* under each model with respect to staffing, management, and capital expenditures (CapEx).

*Government operation*—the airport owner provides the labor, management, and capital funding.

*Service contracts*—the contractor provides the staffing, the airport owner oversees the performance, and there is no CapEx requirement.

**Table 8.12. Financial responsibilities for staffing, management, and CapEx.**

Model	Staffing	Management	CapEx
Government operation	●	●	●
<b>Private Sector Models</b>			
Service contracts	●	○	n.a.
Airport-wide management contract	●	●	n.a.
Developer financing/operation	○	●	●
Long-term lease or sale	●	●	●
Legend:			
●	Operator (government or private) <b>provides</b>		
○	Operator (government or private) <b>oversees</b>		
n.a.	Not applicable		

*Management contract*—the contractor provides the staffing and management, but has no responsibility for CapEx.

*Developer financing/operation*—the contractor contracts out most of the operation, manages the facility, and provides the financing.

*Long-term lease or sale*—the contractor provides the staffing, management, and financing of airport operation and development.

5. **Economic** refers to both enterprise and external impacts. Enterprise economic impacts pertain to the overall economics of the transaction for the airport owner and its tenants. External economics refer to the economic development impacts and associated costs and benefits of the transaction to the community or region served by the airport. Airports create tremendous economic value for the local economy by attracting and retaining industries and creating new jobs.

6. **Commercial** refers to the profit to be earned by the contractor, which is what motivates the private company. The higher degree of commercialization, the higher the level of potential profit over the term of the lease.

7. **Labor** refers to commitments to existing employees under collective bargaining agreements, local laws, and political acceptance.

8. **Customer Service** refers to the experience of passengers, airlines, and other tenants using the airport as well as residents living in the vicinity of the airport.

9. **Implementation** refers to the ability to successfully complete the transaction and to derive value from it over the long-term.

Table 8.13 provides a provisional evaluation checklist for the airport owner.

**Table 8.13. Evaluation checklist.**

Issues	Yes	No	n/a
<b>Governance</b> <ul style="list-style-type: none"> <li>▪ Compatibility with goals for future role in airport ownership/management</li> <li>▪ Retention of residual controls for key policy issues</li> <li>▪ Opportunity for local/regional participation</li> <li>▪ Appropriate level of sponsor/public control over policy and operations</li> <li>▪ Ability to implement economic development initiatives</li> </ul>			
<b>Regulatory</b> <ul style="list-style-type: none"> <li>▪ Compatibility with FAA requirements</li> <li>▪ Requirements to repay federal/state grants</li> <li>▪ Deed restrictions</li> <li>▪ Compatibility with state legal constraints (e.g., police powers, local government charters, municipal authorities, procurement rules, sale or lease of public property)</li> </ul>			
<b>Legal</b> <ul style="list-style-type: none"> <li>▪ Requirements in collective bargaining agreements</li> <li>▪ Covenants in bond indenture, including release of revenues, ability to meet the rate covenant, long-term lease or sale of property, changes affecting the tax status of outstanding debt</li> <li>▪ Requirements in leases with existing tenants, including airline use and lease agreements</li> <li>▪ Responsibility for environmental liability</li> </ul>			

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Table 8.13. (Continued).

Issues	Yes	No	n/a
<b>Financial</b> <ul style="list-style-type: none"> <li>▪ Financial return to airport owner</li> <li>▪ Potential to improve financial operations of airport</li> <li>▪ Access to federal and state grants</li> <li>▪ Need to refund outstanding debt and associated cost of the transaction</li> <li>▪ Timely access to debt financing for capital improvements and requirements to access tax-exempt debt</li> <li>▪ Financial capacity of private sector partner</li> </ul>			
<b>Economic</b> <ul style="list-style-type: none"> <li>▪ Ability to implement airport efficiency initiatives</li> <li>▪ Ability to implement more efficient procurement and contracting mechanisms (e.g., purchasing, personnel, contracting)</li> <li>▪ Ability to enhance non-aeronautical revenues</li> <li>▪ Ability to develop facilities and promote air service more efficiently and aggressively</li> <li>▪ Ability to develop the airport in a manner that promotes regional economic development</li> </ul>			
<b>Commercial</b> <ul style="list-style-type: none"> <li>▪ Requirements to renegotiate airline lease and use agreements</li> <li>▪ Requirements to renegotiate other major lease and use agreements (e.g., terminal concession, parking, rental cars)</li> <li>▪ Ability to increase emphasis on commercial and economic development</li> </ul>			
<b>Labor</b> <ul style="list-style-type: none"> <li>▪ Flexibility to structure compensation and benefit packages to attract and retain management talent</li> <li>▪ Requirements in collective bargaining agreements regarding placement process for existing employees (e.g., retain, reassign to another public agency, or displace)</li> <li>▪ Labor ties to owner</li> <li>▪ Responsibility for pension liabilities</li> <li>▪ Requirements under state laws on replacement retirement package</li> <li>▪ Obligations under “successor clauses” and ability to renegotiate labor agreements</li> <li>▪ Limitations in state laws regarding outsourcing</li> <li>▪ Need for management continuity and experience and transition issues</li> </ul>			
<b>Customer Service</b> <ul style="list-style-type: none"> <li>▪ Ability to maintain or improve levels of service</li> <li>▪ Existence of reasonable prices</li> <li>▪ Access to a wide variety of concession opportunities and other amenities</li> <li>▪ Ability to address external impacts and implement mitigation measures (e.g., aircraft noise, ground access)</li> </ul>			
<b>Implementation</b> <ul style="list-style-type: none"> <li>▪ Implementation risk</li> <li>▪ Implementation complexity/controversy</li> <li>▪ Experience, capability, and financial resources of contractor</li> <li>▪ Long-term value for money</li> </ul>			

## CHAPTER 9

# Case Studies

Case studies can be a useful means of illustrating first-hand experiences and lessons learned from those experiences and therefore can provide helpful background for any airport considering the various privatization models. The purpose of this chapter is to summarize the lessons learned from the case studies that were undertaken for a range of airport sizes, privatization strategies, and forms of governance. They were conducted for successful and unsuccessful efforts. The following information comes from the case studies in Appendix H which documents in more detail (1) the initial goals and objectives of the airport sponsor for undertaking the privatization initiative, (2) a summary of the process employed, (4) a summary of the business terms of the initiative, (4) documentation of the experience to date, and (5) lessons learned. It is recommended that the reader review the case studies in their entirety to better appreciate the unique circumstances surrounding each case.

Case studies for U.S. airports consisted of:

Airport System Management Contract:

1. **Indianapolis Airport Authority**—airport system comprising a medium-hub airport and five general aviation airports, which entered into an airport system management contract that later reverted back to public operation.

Developer Financing and Operation:

2. **John F. Kennedy International Airport Terminal 4 (JFK IAT)**—large-hub airport, private development, financing, and operation of a major international unit terminal.
3. **Boston Logan International Airport Terminal A**—large-hub, terminal development, where private developer financing was initially considered, then airline special facility financing was undertaken, which was followed by the airline's bankruptcy resulting in a workout that required an amendment to the transaction documents.

APPP Applicants:

4. **Stewart International Airport**—non-hub airport and only airport approved under the APPP, which reverted back to public operation.

5. **Chicago Midway International Airport**—large-hub airport that occupies the only large-hub slot under the APPP, which was put on hold after the financial crisis in the fall of 2008.

The case studies for Stewart International Airport and Midway Airport provide interesting contrasts and helpful background for any airport considering privatization under the APPP.

Full Privatization Outside the APPP:

6. **Morristown Municipal Airport**—general aviation airport with long-standing, long-term airport-wide management and development agreement.

## Summary of Case Studies

Summaries of the U.S. case studies are available here and fuller summaries follow. The full case studies can be found in Appendix H.

### Indianapolis Airport Authority

**Type of Transaction:** Airport-wide Management Contract

**Airports:** Indianapolis International Airport and five general aviation airports

**Airport Owner:** Indianapolis Airport Authority

**Private Contractor:** BAA Indianapolis LLC

**Objectives:**

- Attract new airline service and encourage economic development by reducing airline costs through increased nonairline revenues and reduced operating expenses
- Improve customer service and quality
- Increase the expertise and diversity of Airport staff

**Level of Interest:** Four private-sector firms plus the existing Airport Authority staff submitted proposals

**Solicitation Timeline:** RFQ issued in September 1994

**Contract Execution:** October 1995

**Contract Duration:** Initially 10 years, but extended to December 2007 and later terminated in June 2007

**Transaction Features and Highlights:**

- BAA was initially compensated on the basis of savings in airline payments per enplaned passenger versus a base-line cost defined in the contract
- The agreement was amended to change the compensation methodology by providing for a fixed and a variable component due to the difficulty in determining the savings
- The variable component was based on performance achieved towards different goals as opposed to the single goal of reduction of airline CPE
- The Authority reassumed control of the airport system following the early termination of the agreement in June 2007
- BAA was not released from the requirements of Authority procurement ordinances
- Once initial efficiencies had been gained by BAA, it became difficult to make ongoing improvements with effects similar in magnitude and parties started questioning the value gained by retaining BAA relative to the fixed annual fee

## John F. Kennedy International Airport Terminal 4

**Type of Transaction:** Developer Financing and Operation

**Airport:** John F. Kennedy International Airport

**Airport Owner:** Port Authority of New York and New Jersey

**Private Contractor:** JFK International Air Terminal LLC (JFKIAT), a joint venture of LCOR JFK Airport, LLC, Schiphol USA Inc., and Lehman JFK LLC; LCOR and Lehman left the joint venture in 2010 coincident with the announcement of the Delta expansion

**Objectives:**

- Preserve financing capacity for the Port Authority's 5-year capital program
- Minimize construction risk and management oversight
- Reduce operational responsibilities
- Deliver a functional terminal on time and on budget with no additional financing required by the Port Authority
- Improve operational efficiency and increase terminal capacity by replacing exclusive use arrangements with common use arrangements and new pricing approaches
- Gain PPP experience for possible deployment to other agency operations

**Level of Interest:** Four proponents responded to the RFP

**Solicitation Timeline:** RFQ issued in July 1995

**Contract Execution:** May 1997

**Contract Duration:**

- The lease term was to expire on the earlier of the date (1) 25 years after the date of beneficial occupancy of the

new facility, or (2) the day prior to the date on which the Port Authority's lease with the City of New York for JFK (which was 2015 at the time the lease was signed)

- Due to a significant capital expansion negotiated in 2010 to accommodate the operations of Delta Air Lines, the contract was extended through the earlier of 30 years from the date of beneficial occupancy of the expanded terminal or December 2043

**Project Cost:** 1997 initial project: \$1,069 million; 2010 expansion project: \$660 million

**Transaction Features and Highlights:**

- JFKIAT was the first private, nonairline entity to develop and operate an international air terminal in the United States
- The lease required that JFKIAT complete the project within 5 years from the execution of the lease or face significant financial penalties
- The project was completed on time, but at a construction cost approximately 20% over the budgeted amount
- The cost overruns required that JFKIAT obtain completion financing, which was provided by the Port Authority and subordinate to the special facility bonds issued for the initial financing
- JFKIAT sets airline rates and charges to reflect market demand for the facilities it offers rather than use cost-recovery formulas like most U.S. airports, including off-peak rates and volume discounts
- In August 2010, the Port Authority, JFKIAT and Delta announced plans for a \$660 million expansion to accommodate the operations of Delta
- The execution of the long-term lease with Delta in 2010 significantly changed the nature of the transaction to have features more similar to an airline special facility lease

## Boston Logan International Airport Terminal A

**Type of Transaction:** Developer Financing and Operation

**Airport:** Boston Logan International Airport

**Airport Owner:** Massachusetts Port Authority (Massport)

**Private Contractor:** Delta Air Lines

**Objectives:**

- Introduce private sector participation into airport operations
- Redevelop Terminal A while preserving the Authority's financing capacity for its sizable capital program

**Level of Interest:** Seven teams submitted qualifications and five were short listed

**Solicitation Timeline:**

- 1996–1997: Massport studied approaches for private development and went through a competitive selection process that was abandoned
- 1998: Discussions were initiated with Delta

**Contract Execution:** August 2001

**Contract Duration:**

- Initial term began on the opening day (March 16, 2005) and lasted 5 years
- Extension terms provided for 20 automatic one-year extensions unless Delta was in default
- After Delta filed for bankruptcy, the “Amended and Restated Lease” term was also reduced from 25 to 10 years and Delta returned approximately one-third of its space

**Project Cost:** 1997 project: \$1,069 million (versus budget of \$876 million); 2010 expansion: \$660 million

**Transaction Features and Highlights:**

- Initially Massport explored a private developer approach for the replacement terminal, but due to state public bidding laws, and the private developers’ requests “to shift risk to the Authority” or for “subsidies” such as a share of rental car commissions, this approach was deemed infeasible
- The negotiating process was lengthy and complex, in part to ensure that (1) the terminal’s design and construction met Massport’s goals and (2) it provided Massport with the ongoing flexibility after the terminal’s opening to maximize the utilization of the terminal and site
- Unlike most special facility-backed terminal financings for airline tenants, this transaction gave Massport considerable leverage to take back facilities under certain circumstances
- Massport retained control of and the revenues from the Terminal A concessions
- The lease required that Delta complete the project within 5 years from the execution of the lease
- Six months after the opening of new Terminal A, Delta filed for Chapter 11 bankruptcy
- As part of a complex restructuring of Delta’s terminal lease and financing arrangements, Massport, Delta, the bond trustee, and the bond insurer negotiated amended terms to the Terminal A lease to avoid litigation over Delta’s potential rejection of the lease

## Stewart International Airport

**Type of Transaction:** Long-Term Lease Inside the APPP

**Airport:** Stewart International Airport (SWF)

**Airport Owner:** New York State Department of Transportation (NYSDOT)

**Private Contractor:** UK-based National Express Group (NEG), with the long-term lease subsequently acquired by the Port Authority of New York and New Jersey

**Objectives:**

- Leverage the expertise of the private sector to develop the underutilized airport to its fullest potential
- Develop the real estate on the vast site to create jobs and economic development, which was a priority for the

Hudson River Valley due to large industrial concerns laying off workers and closing plants at the time

- Get out of the business of managing airports
- Introduce private sector participation into airport operations

**Level of Interest:** Four private-sector firms and the existing Airport Authority staff submitted proposals

**Solicitation Timeline:** Five teams submitted proposals, of which four were deemed qualified bidders

**Contract Execution:**

- Lease signed November 1999
- Lease became effective in April 2000 after state comptroller, state attorney general, and FAA approval

**APPP Timeline:**

- October 23, 1997, NYSDOT filed a preliminary application for participation
- January 10, 1999, NYSDOT filed its final application
- February 16, 1999, in an effort to clarify certain parts of the application, FAA staff requested responses to questions from NYSDOT and NEG
- April 8, 1999, the FAA published a Notice of Receipt of Final Application in the Federal Register
- June 12, 1999, a public meeting was held
- March 30, 2000, the FAA issued its Record of Decision approving the privatization application and approved the requested federal exemptions

**Contract Duration:** 99-year lease, but NEG sold its interests in the remaining 91 years of the lease to the Port Authority of New York and New Jersey in October 2007

**Transaction Value:** Initial Lease Payment of \$35 million and annual payments equal to 5% of gross income that were projected to begin on or about the 10th anniversary of the lease

**Transaction Features and Highlights:**

- Stewart International Airport was the first and only airport to complete the APPP process
- NYSDOT contracted with private companies to operate parking facilities, cargo facilities, and rest of the airport (under an airport-wide management contract); therefore, a significant amount of SWF operations were already outsourced to contractors
- The RFP gave the bidders the option of proposing on (1) the airport, (2) just the undeveloped land west (approximately 5,600 acres), or (3) both
- NEG elected not to bid on the undeveloped land, and at the encouragement of environmental groups, most of the undeveloped land was set aside by the state under a “forever green” statute
- NYSDOT did not request an exemption for use of airport revenue for general purposes because the airlines declined to approve NYSDOT’s request for an exemption
- Shortly before the beginning of the lease term in November 1999, NEG asked NYSDOT to be relieved of its lease

obligations after reconsidering the company's strategic priorities and interests in remaining in the airport industry

- The transaction prohibited the sale of the lease to another party for 5 years
- NEG paid \$35 million in an upfront lease payment and made \$10 million in capital contributions at SWF during its operation of the airport
- NEG sold the lease after 7 years of operation to the Port Authority for \$78.5 million, allowing it to recover its investments and realize a significant capital gain
- Because the Port Authority is a public agency and not a commercial entity, the airport was no longer eligible to continue in the APPP under Port Authority control and its participation in the program was terminated

## Chicago Midway International Airport

**Type of Transaction:** Long-Term Lease Inside the APPP

**Airport:** Chicago Midway International Airport

**Airport Owner:** City of Chicago

**Private Contractor:** The winning bidder was Midway Investment and Development Company LLC (MIDCo), a consortium comprised of Vancouver Airport Services Ltd. as the operator, and Citi Infrastructure Investors and John Hancock Insurance Company as investors

### Objectives:

- Maximize sale proceeds for the City's unfunded pension liability, infrastructure improvements, and other general fund purposes (primary objective)
- Establish a new framework of rates and charges that provides lower and more predictable rates for airlines operating at the Airport
- Improve the competitive position, service quality, growth prospects and efficiency of Midway Airport for the benefit of Chicago residents, airlines, and other users
- Ensure that future Airport development is safe, functional, efficient and delivered when necessary
- Minimize the City's exposure to residual risks and liabilities from the process
- Ensure fair and equitable treatment of existing Airport employees
- Ensure a smooth transition from public to private management in a timely manner

**Level of Interest:** Six groups submitted qualifications, one was eliminated due to lack of qualifications, two teams decided to withdraw, leaving three teams that submitted bids

**Solicitation Timeline:** RFQ issued February 2008

**Contract Execution:** The deal fell through in April 2009 after the consortium was unable to come up with the full upfront rent payment and had to pay the city a \$126-million breakup fee

### APPP Timeline:

- September 16, 2006: Chicago filed a preliminary application for participation
- October 14, 2008: Chicago filed its final application for review and approval
- January 12, 2009: the FAA said its final review of the privatization application could not be completed because critical financial documents had not been submitted (financial agreements)
- November 8, 2008: FAA held a public meeting in Chicago to receive public comments
- April 1, 2009: the FAA granted its 1st extension to the City to provide additional information
- Several extensions have been provided since April 2009

**Contract Duration:** 99 years (proposed)

**Transaction Value:** \$2.521 billion upfront payment (proposed, but not paid)

### Transaction Features and Highlights:

- The City of Chicago holds the only large-hub slot under the APPP
- The City was the only APPP applicant to secure airline approvals for its exemption to use airport revenue for general purposes after a lengthy negotiation resulting in an agreement that (1) capped airline rates and charges at a level below total 2008 charges and freeze rates for the first six years, (2) limited future rate increases to inflation for the remainder of the 25-year use agreement, (3) granted the airlines approval rights for capital improvement costs to be included in airline rates, (4) provided strong operating and service performance standards, and (5) gave the airlines sign off rights on the bidders' qualifications
- Under special state legislation that was secured, private investors who lease Midway would be guaranteed property tax exemptions; however, runways could not be expanded beyond the current boundaries and all city workers directly employed at Midway must be offered substantially similar jobs at comparable pay
- On the basis of discussions with potential bidders, the City decided to maintain responsibility for police and fire functions for Midway to mitigate the risks perceived by the potential bidders
- Some people believe the only reason the transaction failed to reach financial close was due to the collapse of the debt and equity markets while other people have expressed skepticism on the ability for MIDCo to be able to make a profit, which is why they were unable to get financing
- The \$2.52 billion bid translated into an EBITDA multiple of 28x and might now be viewed as a high-water mark for airport valuations (London City Airport achieved a 30x multiple on the sale to GIP/AIG in 2007 and the failed 40x multiple valuation of a 60% stake in Auckland



International Airport by Dubai Aerospace Enterprise also in 2007 was the highest ever and an outlier)

## Morristown Municipal Airport

**Type of Transaction:** Long-Term Lease/Management Contract Outside the APPP

**Airport:** Morristown Municipal Airport (MMU)

**Airport Owner:** Town of Morristown

**Private Contractor:** DM AIRPORTS, LTD. (DM), an affiliate of the DeMatteis Organizations

### Objectives:

- Pay off \$2 million in airport long-term debt
- With the aid of federal and state grants, make substantial upgrades to the airport's infrastructure that was in a state of disarray with the airport's corporate users threatening to leave and the FAA threatening to close the facility if upgrades were not made to the airport
- Turn the airport into an economic catalyst for the town and the region

**Level of Interest:** The town studied various proposals and considered several potential developers to run the airport

**Solicitation Timeline:** Proposals entertained during 1981

**Contract Execution:** December 1981

**Contract Duration:** 99 years

**Transaction Value:** Annual lease payments to (1) pay annual rent to the town (intended to cover the town's costs associated with the airport under DM's operation, which consist of police services, auditing, and grant administration), (2) pay all outstanding airport debt service when due (\$2 million was outstanding), and (3) undertake all capital improvements

### Transaction Features and Highlights:

- DM has wide discretion and is responsible for making decisions regarding the development of MMU (i.e., capital improvement projects) and managing its operation, which includes among other things, negotiating leases, handling staff and services, and setting rates, fees, and charges
- The only residual airport controls retained by the town are the signing of airport grants and approval of site plans, but the town is obligated to mutually cooperate with DM in securing such approvals
- DM retains all revenues derived from its operation of the airport
- The lease also gives DM the right to mortgage all or any portion of its interest in the lease (without the town's consent) to obtain the most favorable financing needed for airport development
- The lease is assignable "without restriction of any kind"
- Although DM is the primary interface with the FAA and other federal agencies, the town remains the airport

sponsor and must execute grant agreements; however, DM is responsible for all grant compliance

- DM initially contracted the management and operation of the airport to an airport management company because it did not have this expertise, but in 1992, after having achieved stability within the airport management team, DM allowed the contract to expire and hired the airport management staff to work directly for it

## 9.1 Indianapolis Airport Authority

### 9.1.1 Transaction Background

In the 1990s, Mayor Stephen Goldsmith pursued many privatization initiatives as the City of Indianapolis faced pension funding deficits, unfunded infrastructure needs, and increased competition from suburban municipalities for jobs and wanted to establish Indianapolis as a leader in privatization.

In 1994, the Indianapolis Airport Authority, a municipal corporation formed in 1962 and governed by an eight member board (with five members appointed by the mayor of Indianapolis), solicited bids to manage its airport system that included Indianapolis International Airport and five general aviation airports. The authority board created a managed competition committee to oversee a competitive bidding process for the rights to operate, maintain, and manage the airport system. Although the board considered an outright sale or lease of the authority's airports, it decided against doing so because of the difficulty in getting regulatory approval.

The winning bidder, BAA Indianapolis LLC, won a 10-year management contract extending from October 1, 1995 through September 30, 2005.

The Authority staff participated in the competitive bidding process against four private sector firms, but lost the competition to BAA Indianapolis LLC, a subsidiary of BAA USA, which was a subsidiary of BAA International (collectively BAA).

Under the terms of the management contract, BAA was to be compensated on the basis of savings in airline payments per enplaned passenger versus a hypothetical baseline cost defined in the contract. BAA and the Authority agreed to share in the reduction in airline payments per enplaned passenger versus the projected baseline assuming no efficiencies were gained. The savings were calculated annually as the difference between the baseline and actual airline payments per enplaned passenger number, times the number of enplaned passengers for that year. The agreement provided for BAA to receive 32.5% of the savings as a management fee, subject to a \$4 million annual cap, escalated for inflation. The Authority's share of the savings (67.5%) would accrue to the airlines in the form of reduced

rates and charges. (In essence, the airlines were to receive \$0.675 of every \$1.00 of savings produced by BAA.)

During 2002 (and into early 2003), the Authority and BAA negotiated an amendment to the management contract, which was contemplated in the seventh year of the contract. Both parties had an incentive at the time to negotiate the extension. The Authority was motivated to change the compensation structure, as the annual processes required to calculate the fee became increasingly difficult to administer. BAA viewed its contract with the Authority as important experience in anticipation of similar opportunities arising in the future, especially after having its management contract for the Harrisburg airport system terminated in mid-2001. BAA also saw the extension as an opportunity to market planning and development services related to the Midfield Terminal redevelopment, which was at the time expected to be completed by 2007.

### 9.1.2 Objectives

The overarching objective for pursuing a management contract by the Airport Authority was to attract new airline service and encourage economic development by reducing airline costs through increased nonairline revenues and reduced operating expenses.

Other objectives were to improve customer service and quality and improve the diversity and expertise of airport staff.

### 9.1.3 Stakeholder Interests

**Airlines.** Airline tenants were primarily interested in reducing rates and charges, maintaining capital project approval (majority-in-interest) rights, and ensuring that any monies generated on airport remained in the airport system and were not diverted to other purposes. While the airlines were opposed in principle to paying management fees for a private operator, they were the beneficiary of efficiencies achieved at the airport as a result of the “residual” methodology employed for the calculation of airline rates and charges. Notwithstanding this benefit, the airlines regularly questioned the value BAA contributed in relation to its annual fee.

**Labor.** The management contract required BAA to use its best efforts to employ all Authority staff and offer each employee an initial compensation and benefits package similar to what the employee was receiving as an Authority employee. Substantially all Authority staff became employees of BAA.

### 9.1.4 Outcome

Although the Authority initially viewed the managed competition concept as a way to change the way business was

conducted over the long term at the airport, the Authority reassumed control of the airport system following the early termination of the agreement in July 2007. In the end, not all of the expectations were met. The Authority acknowledged that BAA was successful in gaining certain efficiencies and conceded that BAA was able to do so more quickly than the Authority may have been able to do so otherwise. There is also general agreement that BAA’s operation was beneficial for staff as a whole, as employees gained broader airport management expertise and the opportunity to interact with colleagues in the United Kingdom. This interaction was valuable, as it brought to staff the private sector airport management perspective.

BAA assumed operational control in the year that reflected budget cuts implemented by the Authority in advance of the competitive bidding process. Under the terms of the management contract, in which the baseline was projected from the year before the reductions, BAA received the benefit of most of these operating expense cuts. As rental car and terminal concession agreements expired, BAA negotiated more favorable financial terms. BAA fully implemented the successful Pittsburgh “AirMall” concept with street pricing at the airport, which it later introduced at the airports serving Baltimore, Boston, and Cleveland. Although various attempts were made to increase parking revenues with the introduction of new products such as valet parking, most of these initiatives were not deemed to be particularly effective. While BAA did pursue outsourcing of services such as janitorial, in general, the savings were not significantly greater than the contracts the Authority already had in place. Air service marketing efforts were expanded, but without achieving the desired effect of new international service.

From the first year of the contract, it became apparent that the compensation methodology prescribed by the agreement would be difficult to administer. Since under the residual airline ratemaking structure, the airlines ultimately paid BAA’s management fee, they lobbied the Authority to ensure that BAA did not receive the benefits of “windfall improvements” not subject to BAA’s control. To protect its financial interests, BAA spent much time and effort in documenting and estimating the effects of its efforts. The financial effect of many of BAA’s initiatives, such as implementing a new customer complaint program for parking operations, employee training programs, and new schedules and other changes to shuttle bus operations, were impossible to measure meaningfully.

The structure of the compensation calculation disincentivized BAA from implementing any customer service initiative that resulted in increased operating expenses, even though improved customer service was cited as a goal during the competitive bidding process and was supported by the spirit of the management contract. While the parties attempted in good faith to use a more technical approach to

identify appropriate baseline adjustments in the initial years of the contract, the annual compensation calculation eventually became more of a negotiation. The negotiation became more contentious as the baseline projected in 1994 became increasingly meaningless as a result of changes in the airline industry, the economy, and new security requirements as a result of September 11.

As noted earlier, the arrangement was terminated under mutual agreement by both parties to provide for (1) an early transition of personnel and operations back to the Authority and (2) a smooth transition in advance of the opening of the new \$1.07 billion Midfield Terminal in late 2008. There was no significant change in the operation and management of the airport facilities after the transition.

### 9.1.5 Lessons Learned

Lessons by the stakeholders in the Indianapolis Airport Authority airport system management contract included the following:

- Government departments competing in managed competition efforts can be disadvantaged, as regulations generally prevent them from partnering with private firms or guaranteeing performance. Evaluation criteria may need to be assessed with this potential conflict in mind.
- Whatever metrics are used to gauge performance should be transparent and easily measurable. Improvements made by BAA as measured by airline payments per enplaned passenger were difficult to track as they required the estimation of a hypothetical baseline comparison (including numerous categories of operating expenses and nonairline revenues, which can be extremely variable from year to year). Over the long-term agreement, especially after the operational changes necessitated by increased security measures following the September 11, 2001 terrorist attacks, it became increasingly difficult to estimate meaningfully what the baseline would have been. In this respect, the annual management fee became an annual negotiation between the Authority and BAA and frequently was contentious.
- Tracking contract compliance became a substantial undertaking for the Board, which eventually hired professionals with airport and public management expertise to oversee the contract. Much time was spent defining a peer set of airports to use for benchmarking BAA's performance, with inconclusive results.
- Once initial efficiencies had been gained by BAA, it became difficult to make ongoing improvements with effects similar in magnitude. For this reason, a strategy may be to contract with a private-sector firm on a short-term basis to gain the majority of potential efficiencies before transferring the operational responsibilities back to the public sector. The

Authority-BAA contract worked in this regard to the extent that staff gained broader, international airport management expertise during the term of the contract.

- From BAA's perspective, once initial efficiencies were attained, it became increasingly difficult to attain further improvements and realize the full value of the management fee. Moreover, the relatively small maximum annual compensation amount (initially \$4 million, reduced later to \$1.85 million), while appropriate for a firm that may have viewed the opportunity as a "loss leader" necessary to achieve more lucrative contracts in the future, may not have been enough of an incentive to attain more difficult-to-achieve improvements.<sup>80</sup>
- When many goals are trying to be achieved through privatization, the compensation needs to be tied to each goal. The initial compensation structure for BAA was tied to improvement in one variable—airline payments per enplaned passenger—and not separately to the individual goals the Authority was trying to achieve (e.g., improved customer service and new air service). The amended agreement changed the compensation structure so that BAA was compensated for its progress against separate goals, but the new structure may also have been difficult to truly measure efficiencies for the purpose of justifying compensation.
- To achieve the full benefits of privatization, it may be more effective to contract with multiple firms specializing in each area in which improvement was targeted. While BAA had successful U.S. experience with concession programs, other firms may have had more expertise in areas such as parking or building maintenance. While the management contract allowed BAA to contract with other firms, BAA often was incentivized to maintain as much control as possible.
- With few exceptions, there were no 'magic solutions' that could not have been attained under continued public management. When acquiring services on behalf of the Authority, BAA was not released from Authority procurement regulations, which is often a large motivation in privatization efforts. However, BAA's procurement of goods with their own operating funds was not considered 'public' dollars in the same way as the Authority's funds. Moreover, BAA employed substantially the same staff as the Authority did before. In the end, BAA's approach to improve performance involved typical airport management best practices to increase nonairline revenues with more advantageous contract terms, increase parking revenues without sacrificing market share, increase commercial development, and outsource non-core services. Notwithstanding these

<sup>80</sup>As a point of reference, the management fee for airport management services for Albany International Airport was fixed at \$407,286 in 2010, an airport that accommodated 1.3 million enplaned passengers in 2009, compared with IND's 3.7 million enplaned passengers.

industry-accepted approaches, having a private operator involved may have streamlined and improved certain processes, especially with regard to renegotiating concession, rental car, and other nonairline contracts.

## 9.2 JFKIAT Terminal 4

### 9.2.1 Transaction Background

JFK International Air Terminal LLC (JFKIAT) was formed in 1997 in partnership with the Port Authority of New York and New Jersey (the “Port Authority”) to build, operate, develop, and manage the \$1.4 billion Terminal 4 at John F. Kennedy International Airport (JFK). Terminal 4 replaced the original International Arrivals Building (IAB), which had been built, operated, expanded, and renovated by the Port Authority since 1957. Since the central terminal complex was developed in the late 1950s and early 1960s, the IAB has been the only terminal at JFK not exclusively leased, developed, and operated by airlines. For this reason, the terminal has traditionally housed the operations of numerous foreign-flag airlines, typically operating with low frequencies. (In November 2010, 38 airlines provided service at Terminal 4.)

Recognizing that the IAB no longer functioned efficiently due to insufficient capacity and outdated building systems, the Port Authority initiated in 1993 planning and design studies for its redevelopment. Realizing that the project would require significant capital investment and program management and oversight, the Port Authority decided in 1995 to involve the private sector in the design, construction, and operation of the new facility on the site of the existing IAB.

JFKIAT was selected by the Port Authority following a competitive bidding process. JFKIAT was a joint venture of LCOR JFK Airport, LLC, Schiphol USA Inc., and Lehman JFK LLC. JFKIAT assumed responsibility for the operation of the IAB and development of the new state-of-the-art international terminal building in May 1997 shortly after the financial closing of the special facility bonds issued to finance the project. JFKIAT was the first private, nonairline entity to manage an international air terminal in the United States.

The 1.5-million square foot terminal opened in May 2001 with two concourses (Concourses A and B) and 16 loading-bridge-equipped gates and an apron capable of accommodating up to 24 remotely parked aircraft. Terminal 4 is the largest international terminal in the New York area, with federal inspection services (FIS) facilities capable of processing 3,200 passengers per hour, and provides the only 24-hour FIS facility at JFK.

Terminal 4 was generally recognized in the industry as the preeminent example of nonairline, private sector participation in terminal development and operation, with benefits having been realized in increased operating efficiency,

enhanced levels of service for passengers and airlines, and reduced operating costs.

In August 2010, JFKIAT, the Port Authority, and Delta Air Lines announced a \$660 million expansion of Terminal 4 (the 2010 Expansion Project), which includes an extension of Concourse B to include nine additional loading-bridge-equipped gates, new airline lounges, centralized security checkpoints, a secure-side connector to Terminal 2, the demolition of Terminal 3, and expanded remote aircraft parking facilities. Construction is expected to begin in the fourth quarter of 2010, with all work to be completed within five years.

In 2010, in connection with the proposed redevelopment, Schiphol acquired the LCOR and Lehman ownership stakes to become the sole partner. Subsequently, Delta bought a non-majority, non-controlling stake in JFKIAT in April 2010.

### 9.2.2 Objectives

After the election of George Pataki as New York governor in 1994, political support of privatization initiatives at state agencies increased. In this environment, the Port Authority<sup>81</sup> began considering involving private sector participation in its operations. The Terminal 4 redevelopment was identified as an attractive opportunity as its cost comprised approximately one-fourth of the cost of the agency’s 5-year capital program and the Port Authority wished to preserve future funding capacity. Other large-scale construction projects were planned or in process at JFK, including the quadrant roadway reconfiguration and the AirTrain rail transit system, which was to connect the terminal complex with subway and regional rail systems. The financial and management resources required to implement these complex projects along with the redevelopment of Terminal 4 provided further encouragement for the agency to explore alternative project delivery methods. Finally, the IAB was operationally intensive, with approximately 230 Port Authority employees staffing the facility at the time.

In summary, the Port Authority’s primary objectives in partnering with the private sector to redevelop the IAB in 1997 were:

- Preserving financing capacity
- Minimizing construction risk and management oversight
- Reducing operational responsibilities
  - Delivering a functional terminal on time and on budget with no additional financing required by the Port Authority

<sup>81</sup>The Port Authority is a bi-state port district established through an intergovernmental contract between the states of New York and New Jersey. The governor of each state appoints 6 members to the Board of Commissioners, which oversees the Port Authority.

- Improving operational efficiency and increasing terminal capacity by replacing exclusive use arrangements with common use arrangements and new pricing approaches
- Gaining PPP experience for possible deployment to other agency operations

### 9.2.3 Stakeholder Interests

**Labor.** The Port Authority required JFKIAT to interview existing staff for possible employment, but JFKIAT was not contractually obligated to employ any staff. The Port Authority guaranteed jobs in other facilities to those not absorbed by JFKIAT and required JFKIAT to include \$4 million in project costs for the Port Authority's costs in realigning the IAB staff, which were mostly early retirement benefits. JFKIAT contracted most services out to third parties in order to realize operating expense efficiencies and the expertise of specialized firms. A number of the Port Authority employees were hired by these third party contractors and many skycaps all went to work for a concessionaire.

**Airlines.** The IAB had historically been served by a large number of foreign-flag airlines, including approximately 45 airlines at the time of the award. Airline interests in the redevelopment of Terminal 4 were divergent, but had the following in common:

- Minimizing the disruption of IAB operations during the construction of Terminal 4
- Replacing the aging IAB with an operationally efficient terminal capable of accommodating forecast demand
- Having certainty with regard to the availability of gate and other facilities for their operations
- Minimizing increases in rates and charges
- Ensuring levels remained competitive with other JFK terminals
- Having the ability to enter into agreements whereby preferential rights such as gate assignments and lower rates and charges could be obtained in exchange for guaranteed activity levels
- Improving customer service and the passenger experience

### 9.2.4 Outcome

At financial closing (April 1997), JFKIAT intended to enter into a guaranteed maximum price (GMP) contract with its construction contractor with a projected date of beneficial occupancy of December 15, 2000. However, JFKIAT was unable to enter into a GMP contract due to the limited set of construction documents. The project was completed in May 2001 at a construction cost approximately 20% over the budgeted amount. (The final cost of construction was approximately \$1,069 million, compared to an original estimate in

1997 of \$876 million.) JFKIAT attributed the cost overruns to (1) staging costs, (2) unforeseen site conditions, (3) subcontractor disputes, and (4) architectural design features. JFKIAT was highly motivated to complete the project by May 8, 2001 (the deadline in the lease) because upon DBO it could increase the per passenger rates and realize significant increased revenues as well as avoid paying a significant penalty under the lease if not finished by then. Due to the loss of time dealing with the existing conditions, it cost more to accelerate the later stages of construction.

The cost overruns required that JFKIAT obtain completion financing, which was provided by the Port Authority through a \$172 million subordinate loan as noted above.

Since its completion in 2001, Terminal 4 has operated successfully, substantially improving operational efficiency compared with the IAB, in large part due to the new state-of-the-art building, and serving many airline tenants with diverse interests. Its operational and pricing structure has enabled it to respond more proactively to changes in the airline industry. As a full common use terminal, Terminal 4 was able to accommodate numerous airlines that operate at relatively low frequencies, thereby increasing utilization versus the IAB.

Terminal 4 has also captured an increased share of passenger traffic at JFK, with its 13.2% share of passengers enplaned in 1999 increasing to 19.9% in 2009. JFKIAT attributes this increase to the terminal's increased capacity and ability to accommodate new entrants. The low frequency airlines that are not affiliated with a major airline alliance generally prefer operating from Terminal 4 over other JFK terminals because it is not operated by an airline. While priority use rights are conferred to some contracting airlines, airlines operating from Terminal 4 have greater certainty that their flights will not be "bumped" due to the scheduling decisions of a landlord airline. Airlines also realize efficiencies in the sense that they can separately negotiate operating agreements with JFKIAT with provisions such as term and guaranteed traffic levels tailored to their needs, as opposed to negotiating under less flexible terms with the airlines operating the other unit terminals.

Internal forecasts of concession revenues that were prepared during the planning process were not realized. JFKIAT attributes this shortcoming primarily to the (1) significantly worse-than-expected sales of duty free goods after the abolition of duty free sales for intra-European Union traffic in July 1999, (2) traffic declines after September 11, and (3) passenger behavior changes after September 11 due to longer security checkpoint times. With the increased security measures put into place following the September 11, 2001 terrorist attacks, passenger behavior has changed with reduced pre-security dwell times as the majority of passengers proceed directly to their departure gates after check-in. Most concession outlets were located pre-security. This problem was

partially addressed by adding concession outlets post security and was addressed in a more comprehensive manner in the 2010 Expansion Project by consolidating and moving the security checkpoints before the main concession courtyard.

JFKIAT has realized savings in operating and maintenance expenses by reducing personnel, outsourcing functions (major maintenance, janitorial and custodial, security, etc.), and introducing efficient work processes. By outsourcing certain services that had traditionally been provided by the Port Authority, JFKIAT was able to reduce in-house headcount by almost 75% (from approximately 230 to 60). Other operating efficiencies such as a building automation system were built into the energy-efficient design of the new terminal. The ability to operate outside of Port Authority procurement procedures, employment pay scales and contracts, and political influence allowed JFKIAT in many cases to obtain more advantageous contractual terms than could have been obtained by the Port Authority. In the end, JFKIAT had a strong incentive to maximize passenger throughput, “run a tight ship” and “sweat the asset,” as it would retain any excess revenues and operational savings.

Terminal 4, which opened in May 2001, underperformed in the first two years of operations (2002–2003), reflecting the difficult operating environment in the early 2000s. The events of September 11, weak economic conditions, outbreak of Severe Acute Respiratory Syndrome (SARS), and Iraq war had a severe effect on international traffic in the United States and at JFK. These unforeseen external factors significantly affected the project’s operating performance. For example, total international passengers at JFK declined 18% between 2000 and 2003. However, since that time Terminal 4 has benefited from a strong recovery in passenger volumes, an associated increase in revenues, and the extension of the debt amortization period for senior and subordinate debt (from 2015 to 2025) as a result of the extension of the City Lease with the Port Authority in 2004.

Ultimately, with the 2010 Expansion Project and Delta’s cost-recovery rates, more than half of Terminal 4 now effectively operates like other airline-financed terminals at JFK.

### 9.2.5 Lessons Learned

The JFKIAT Terminal 4 project was a first-of-its-kind experiment and as a result has provided some lessons learned by the stakeholders, including:

- The ability to access tax-exempt financing made the Terminal 4 redevelopment viable. LCOR estimated the tax-exempt financing provided a roughly 30% discount on private financing.
- Although the Port Authority sought to attract private equity in the project, ultimately its access to the tax-exempt

bond market on behalf of the developers and the associated lower cost of capital disincentivized a large equity investment that would have required higher returns for the developer. JFKIAT’s contribution of \$15 million was motivated by the Port Authority’s desire that the consortium have “skin in the game.”

- JFKIAT was able to successfully experiment with market-based pricing, which very few public airports use. In particular, after the downturn in traffic resulting from September 11 and SARS, as a private entity JFKIAT was able to negotiate special pricing with airlines that could not have been accomplished under typical airport-airline ratemaking agreements.
- Normally in the United States, airport terminals are subsidized by parking and rental car revenues given the large amount of public space. In this case, Terminal 4 had to stand financially on its own without these subsidies. As a result, the JFKIAT model is not universally transferable to other U.S. airports. It worked at JFK because of the inter-airport terminal capacity limitations, high user rate levels for competing facilities, high percentage of international traffic (which can support substantially higher charges), and ability to charge fixed, profit-based pricing to use the terminal. Therefore, the model may not be readily adaptable in other locations without some form of subsidy from other nonairline revenues, particularly parking and rental car revenues. This model is best suited to application at large, multi-airline airports with unit terminals.
- A frequently cited rationale for involving the private sector in facility development is to obtain construction and program management expertise and therefore mitigate the risk of cost overruns and schedule delays. While Terminal 4 was completed on-schedule, the final project cost was about 20% higher than the budgeted cost. One of the complexities in its development was the requirement to remain operational during construction.
- The structure of the financial returns, whereby both the Port Authority and JFKIAT derived residual cash flow value from the project, helped to align a number of their interests. JFKIAT was highly motivated to complete the project as quickly as possible, much like a traditional real estate developer.
- Risk avoidance in general is an overarching rationale for privatization. In the case of Terminal 4, however, one might question the magnitude of the “real” risk that was actually assumed by JFKIAT. JFKIAT only invested \$15 million in equity, but did invest a great deal of time and effort in the venture as well as risk \$33 million in predevelopment expenditures. Regardless of the financial viability of the project, the Port Authority in the end must serve the public interest of ensuring the busiest international terminal in the region remains operational. JFKIAT, on the other

hand, could “walk away” if the operation in its judgment became unfeasible. Ultimately the main risk for the project rested with the bond insurer and bondholders, not JFKIAT or the Port Authority.

- Unlike toll road projects where the term of the transaction is usually 50 years or more, the relatively short term for this transaction (initially 15 years) limited the amount of equity that could reasonably be bid. Given the limited amount of equity, the return on investment is quite large.
- The early years of the lease were the most vulnerable and the Port Authority played an important role in mitigating risk in these early years. When JFKIAT fell upon hard times after September 11 and SARS, in conjunction with the accelerated debt amortization period (prior to the extension of the City Lease) and the need for completion financing, the Port Authority stepped up to assist JFKIAT by amending the lease agreement and providing subordinate financing. Although JFKIAT felt it could access financing from the bond market, the financing provided by the Port Authority provided a win-win solution for both parties as JFKIAT had a credit rating at the time that was below investment grade. The level of cooperation provided by the Port Authority to JFKIAT demonstrated its commitment to the facility and desire for its success.
- The long-term lease meant that control over the site and the flexibility to respond to changing market conditions was relinquished by the Port Authority. While this factor was not important in the early years of operation, it became a more important consideration later on. From a customer service perspective, replacing Terminal 3 was a top priority for the Port Authority, and expanding Terminal 4 was the logical and most economically viable solution. However, the Port Authority only had indirect influence on the outcome of negotiations between Delta and JFKIAT, two parties with competing financial interests. In the end, Delta’s interest to pay cost-recovery rates and Schiphol’s interest to maintain a good relationship with Delta and its SkyTeam partners were met with Schiphol’s purchase of LCOR’s and Lehman’s stakes in JFKIAT. Although a short-term lease may be more appropriate to protect against industry uncertainty, a shorter term would be less attractive to private investors and harder to secure financing.
- Key to the success of the Terminal 4 project was the fact that there was no “anchor tenant,” whose needs were driving facility design and development at the expense of other tenants. With no airline having a large share of traffic at the terminal, any organized opposition to the project was difficult. (These dynamics have changed to some degree as a result of the Terminal 4 expansion project and Delta’s preferential-lease status.)
- The project has also been successful because it is one of several terminals at JFK that must compete for traffic with

other terminals. This competition works to keep rates from becoming unreasonable and to incentivize JFKIAT to run an efficient facility with high customer service standards.<sup>82</sup> Competition between terminals minimizes the need for more heavy handed regulation, as JFKIAT must compete for airline customers.

- JFKIAT also has a strong incentive to maximize the passenger throughput of the terminal based on the per passenger pricing regime and the associated passenger-related concession revenues. JFKIAT is also incentivized to minimize operating expenses; however, maximizing revenues in a competitive environment requires high service levels so the incentives are well aligned for both the Port Authority and JFKIAT.

## 9.3 Boston Terminal A

### 9.3.1 Transaction Background

With political pressure to privatize Boston Logan International Airport and recognizing that a needed redevelopment of Terminal A would require significant capital investment, the Massachusetts Port Authority (Massport) decided in 1996 to explore private sector involvement in the Terminal A project. Initially, Massport explored a private developer approach for the replacement terminal, but due to state public bidding laws, and the private developers’ requests “to shift risk to the Authority” or for subsidies such as a share of rental car commissions, this approach was deemed infeasible. Massport then began negotiations with Delta to develop the new terminal.

New Terminal A was developed under a special facility lease between Massport and Delta and was largely funded with special facility revenue bonds issued in August 2001, which were secured solely by Delta and insured by Ambac Assurance Corporation (Ambac). When the lease was signed on August 16, 2001, the terminal was considered fairly well designed. After the terrorist events of September 11, 2001, Massport and Delta worked together to redesign the terminal to incorporate additional security features and to reduce costs.<sup>83</sup>

Shortly after the opening of new Terminal A, Delta filed for protection under Chapter 11 of the U.S. Bankruptcy Code on September 14, 2005. To assist Delta in its reorganization efforts and to avoid the potential for costly litigation, Massport, with

<sup>82</sup>It should also be noted that JFKIAT has the obligation to provide fair and reasonable fees and avoid unjust discrimination pursuant to its lease with the Port Authority, which is responsible for assuring compliance of federal statutes, DOT/FAA policy, and FAA grant assurances by its tenants and contractors.

<sup>83</sup>Dave Bannard, *Large Capital Projects*, AAAE Airport Magazine, June/July 2010.

the consent of the bond trustee and Ambac, agreed to restructure the original lease and bond trust agreement.

Under the restructuring, Massport is not obligated to make the debt service payments on the Terminal A bonds. If pledged facility rentals and associated reserves are insufficient to make the debt service payments, the payments become the responsibility of Ambac under the terms of the bond insurance agreement.

### 9.3.2 Objectives

Governor Weld was committed to establishing Massachusetts as a leader in privatization. Given the political environment, Massport began considering alternatives for private sector participation in its operations. The redevelopment of Terminal A was identified as an attractive opportunity given its significant cost and Massport needed to preserve financing capacity for the Logan Modernization Program as well as its sizable airfield, sound proofing, major maintenance, and the other port facility improvements.

### 9.3.3 Stakeholder Interests

Delta was the largest carrier operating from Logan (in terms of passengers) when Massport started talking to Delta about Terminal A. Delta wanted to continue to expand its operations at Logan and consolidate all of its product lines at that time in one building, which operated from different terminals at that time. Terminal A was the only site that had enough potential to accommodate all these products in one building. In addition, as the first terminal on the entrance road combined with new state-of-the-art facilities, Delta felt the new terminal would give it a competitive advantage over its competitors at Logan.

### 9.3.4 Outcome

Six months after the opening of new Terminal A, Delta filed for protection under Chapter 11 of the U.S. Bankruptcy Code on September 14, 2005. To assist Delta in its reorganization efforts and to avoid the potential for costly litigation, Massport, with the consent of the bond trustee and Ambac, agreed to restructure the original lease and bond trust agreement. Delta then signed an amended and restated 10-year lease dated July 1, 2006, reducing the number of aircraft gates it leased in Terminal A and associated space by approximately one-third (from 22 to 14 gates). Massport subsequently leased four of the relinquished gates and two regional aircraft ground loading positions to Continental Airlines, under a 5-year lease agreement (that expires in November 2012). After Delta and Northwest merged, Delta leased the remaining gates in Terminal A.

### 9.3.5 Lessons Learned

This hybrid single airline special facility financing had a number of unique characteristics and as a result has provided some interesting and instructive lessons learned, including:

- Despite the representations that developers and infrastructure funds are looking for opportunities to invest private capital in airport assets, as was the case for the JFKIAT project, the prospective developers contended that the Terminal A project could not be economically financed without significant access to tax-exempt debt or other airport revenues.
- The experiences of Terminal A at Logan and Terminal 4 at JFK highlight the difficulties of financing terminal buildings, with their high capital and operating costs, without the higher-margin parking and rental car revenues. A terminal developed by an airline, such as Terminal A at Logan, may be more feasible as the airline may be solving to minimize its overall operating costs rather than seeking satisfactory commercial returns on its investment. In the case of Delta, it was able to consolidate its operations that had been spread over two terminals into one building thereby saving on labor and equipment costs.
- Each state has its own unique set of laws and regulations. When contemplating privatization options, it is important to undertake a comprehensive review of these laws. Given the unique public bidding requirements in Massachusetts, accessing tax-exempt conduit financing for private development was deemed infeasible. Once Massport determined that private developers needed the conduit debt, it had to seek other avenues for private participation in the project.
- When contemplating a special facility financing on behalf of an airline or other party, an airport owner should be careful to ensure that the lease is a single lease that fits the parameters of a true lease (as opposed to a financing lease).
- Logan is primarily an origin-destination (O&D) airport and has a diverse mix of carriers, with no airline accounting for more than 20% of the passenger share in 2010. Under this type of situation an airport owner should consider the desirability of including gate and space take-back provisions, as used in the Terminal A lease, if using special facility debt. Also, an airport should evaluate the merits of maintaining the facility on behalf of the airline (and charging associated rent) and retaining control over the concessions (and associated revenues).
- With respect to the construction side of the project, the lessons learned are best summarized by Massport's deputy chief legal counsel assigned to the Terminal A transaction:

Take the time to carefully and clearly document the parties' understanding before commencing the work, but provide for flexibility within that framework; ensure that everyone involved



in the project understands what has been agreed upon; maintain continuous communication throughout the project; and craft a structure that aligns all parties' goals. By taking time upfront, significant time and money can be saved in the long run.<sup>84</sup>

- The lease required that Delta make annual maintenance reserve payments so that funds would be set aside for facility renovation, renewal, replacement, or reconstruction, and for unusual or extraordinary maintenance or repairs. This feature addresses concerns about a private tenant turning back a facility at the end of a long-term lease in poor condition. Funds in the Terminal A maintenance reserve account can be dispensed at Massport's discretion.

## 9.4 Stewart International Airport

### 9.4.1 Transaction Background

In 1999, Stewart International Airport (SWF) became the first and only<sup>85</sup> airport to complete the APPP process. It was operated by a subsidiary of UK-based National Express Group (NEG), under a 99-year lease with the state of New York (the owner). NEG operated the airport from November 1, 1999 through October 31, 2007, when it sold the remaining 91 years of the lease to the Port Authority of New York and New Jersey. Because the Port Authority is a public agency and not a commercial entity, the airport was no longer eligible to continue in the APPP under Port Authority control and its participation in the program was terminated.

### 9.4.2 Objectives

Governor George Pataki wanted to be a leader in public asset and operation privatization alternatives and SWF was determined to be a good candidate for privatization. He believed that turning the airport over to the private sector would provide the Hudson Valley region with better air service, greater economic development, and a strengthened tax base. Therefore, the primary motivations were to (1) leverage the expertise of the private sector to develop the underutilized airport to its fullest potential and (2) develop the real estate on the vast site to create jobs and economic development, which was a priority for the Hudson River Valley due to large industrial concerns laying off workers and closing plants at the time. The RFP gave the bidders the option of proposing on (1) the airport, (2) just the undeveloped land (approximately 5,600 acres), or (3) both.

In addition, it was recognized that managing airports was not a "core business" for the state and the New York

Department of Transportation (NYSDOT) was continually funding SWF with no prospect of financial return.

Finally, the certain parties to the transaction felt that NEG would turn the airport around, develop Stewart to its fullest potential, and consummate a landmark transaction that would become a model for airport privatization throughout the country.

### 9.4.3 Stakeholder Interests

**Airlines.** The airlines declined to approve NYSDOT's request for an exemption to use airport revenue for general purposes because they were concerned that granting the exemption for SWF would establish a precedent that could be used in the privatization of larger airports. Therefore, when filing its final APPP application for SWF, NYSDOT did not request an exemption for use of airport revenue for general purposes.

**Labor.** Under the APPP statute, all collective bargaining agreements covering airport employees that are in effect on the date of the sale or lease of the airport cannot be abrogated by the sale or lease. Therefore, NYSDOT required NEG to develop a plan offering existing NYSDOT employees at the airport the option to remain in the employment of NYSDOT or to receive an offer of employment with NEG. One of the conditions of the lease was to retain the State Troopers as the airport security to avoid labor issues.

NYSDOT contracted with Air Group International (AGI) to operate the airport under a management contract. In addition, the parking operations were contracted to another private entity and NYSDOT leased the airport's cargo facilities. While the ownership of SWF resided with NYSDOT, a significant amount of SWF operations were outsourced to contractors.

**Community.** The goals of the Stewart Airport Commission (SAC), which acts in an advisory only capacity and has no governance authority over the airport, were and continue to be (1) improve passenger air service and (2) contribute to the region's economic development. Under the lease, NEG was required to meet on a regular basis with SAC.

### 9.4.4 Outcome

Shortly before the beginning of the lease term in November 1999, NEG approached NYSDOT asking to be relieved of its lease obligations. Apparently, NEG had already started thinking about getting out of the airport business to focus on its core business in the bus and rail sectors, and in February 2001 sold its only other airport operations (3 airports in England). NYSDOT refused the request and NEG proceeded

<sup>84</sup>Dave Bannard, *Large Capital Projects*, AAAE Airport Magazine, June/July 2010.

<sup>85</sup>As of November 2011.

as contracted to take over SWF operations. Moreover, the SWF transaction prohibited the sale of the lease to another party for 5 years, or until November 1, 2004.

NEG hired an experienced airport manager to run SWF who was not an employee of NEG but was a contractor. The airport manager continued in that position until the airport lease was taken over by the Port Authority and reported to NEG's U.S. subsidiary, which was a large bus operation. SWF had to perform as a competitive business enterprise within the NEG family of companies. Ongoing corporate investments and initiatives had to be justified by reasonable expectation of a satisfactory financial return over the life of the investment. Potential SWF investments also had to compete with potential rail and bus investments within NEG's capital portfolio. Beyond the lease commitments, investments at SWF had to be as good as or better than alternative NEG investments.

NEG took over operations roughly 10 months before the terrorist events of September 11 and managed SWF during a difficult period for regional airports. It competed successfully for AIP grants and worked to attract real estate development and airline service, including JetBlue and AirTran (which subsequently exited the market). In terms of the profits from airport operations, the FAA concluded that despite a steady decline in passengers after NEG took over operation, NEG's profit was similar to that achieved by NYSDOT under its last full year of operation, which was likely a result of operating efficiencies achieved by NEG.<sup>86</sup>

Although the SWF privatization did not materially improve passenger air service, it did continue economic development activity related to the airport and was able to accelerate construction projects relative to public operation.

#### 9.4.5 Lessons Learned

SWF's entry and exit from the APPP provided a first-of-its-kind experiment and as a result has provided some interesting and instructive lessons, including:

- As demonstrated by other case studies, strong political commitment was necessary to achieve privatization. The reason the initial privatization process succeeded was because Governor Pataki was a strong political champion.
- Navigating through the APPP process took the state considerable time and resources (as it did for the city of Chicago). It took 34 months from the time NYSDOT submitted its preliminary application to the FAA until the FAA issued its record of decision approving the transaction. The process included preparing the preliminary APPP application,

developing the RFP, evaluating the responses, selecting an operator, drafting and negotiating the complex lease terms, preparing the final APPP application, managing public participation, securing local approvals, and building political support. In considering the timeline, it is important to remember that there are both federal and local requirements. In the case of the SWF privatization, local approvals were required from labor groups, the state attorney general, and state controller, among others. It is important to remember, too, that this was the very first such transaction in the U.S., undoubtedly adding to the length of time required.

- Although the state and NEG thought it was reasonable to include the cost of capital in the airline rates over and above allowances for inflation without having to seek airline approval under the APPP, the FAA said that rates could not increase faster than the rate of inflation without airline approval.
- For-profit private companies must make strategic decisions in the interests of their shareholders, which may not always be in the best interests of the airport community. After operating the airport for 7 years, NEG was no longer interested in investing resources in airports. NEG exited the airport industry and concentrated on its core rail and bus businesses. There was no appetite to invest seed money into the airport because NEG was looking for an immediate financial return. As a result, total operating revenue remained flat at best during the NEG operation. NEG fulfilled its lease requirements, but the original enthusiasm and energy for the business waned, and the state was disappointed that additional investments did not materialize. There is no guarantee that the private airport operator will achieve financial success, retain interest in the business, or be successful in its execution. Therefore, the challenge in structuring a successful transaction is to align the interests of the private company with the appropriate incentives.
- NEG paid \$35 million in lease payments and made \$10 million in capital contributions at SWF. It did not materially improve SWF's financial performance during its tenure, in part due to the significant cutbacks in air service after September 11, and in part due to the realignment of the company's strategic priorities. It is likely that NEG did not realize the return on its investment as expected during its operation of the airport. In addition, NEG was facing a 5% of gross income lease payment beginning on the 10th anniversary that would further dilute its earnings. NEG sold the lease after 7 years of operation to the Port Authority for \$78.5 million, allowing it to recover its investments and realize a significant capital gain, which was not plowed back into airport improvements.
- One of the intentions of the APPP was to evaluate the potential for new private sector investment in airports through privatization. Indeed NEG invested \$10 million of its own funds into SWF capital development, but it also received a

<sup>86</sup>U.S. Department of Transportation, Federal Aviation Administration, *Report to Congress on the Status of the Airport Privatization Pilot Program*, August 2004.

significant return on that investment and its \$35 million lease payment from the sale of the remaining leasehold interest.

- While there was significant economic development associated with SWF during the privatized period, the community's principal goal of improved air service was not achieved. There is only so much a regional airport operator can do to entice sustainable air service. Some believe that the Port Authority has considerably more leverage to entice airline service at SWF due to its control over JFK, LaGuardia, and Newark airports, and its ability under federal law to potentially cross-subsidize the facility. However, this remains to be seen.
- One of the reasons NEG's bid was considered the most attractive was due to its plans to operate express bus service between New York City and SWF similar to the services it operates linking the London airports. It was expected that the SWF bus service would stimulate low fare service from the airport; however, the bus service plan was never implemented.
- SWF was improved on the margin by NEG due to the new leases and commercial development; however, the airport experienced significant challenges before, during, and after privatization—enplaned passenger traffic peaked in 1997 at 435,000, troughed in 2002 after September 11 at 170,000, peaked again in 2008 at 446,000, and then declined sharply again in 2009 to 187,000. Neither privatization nor public operation is a panacea for an airport that experiences challenges attracting demand.
- The state's 5-year prohibition from selling the lease worked well. It was designed to prohibit the bidder from flipping the airport for a profit shortly after the transaction.
- The Port Authority has the resources and capacity to make large investments in SWF to implement a long-term vision without expecting short-term financial returns. It does not have to justify its SWF investments and initiatives on a current business basis. As such, the Port Authority has the flexibility to implement a longer-term vision of SWF as a significant reliever airport for the greater New York area by making the infrastructure improvements and offering the marketing and financial incentives to achieve this vision.
- A more local governance structure, such as ownership by the county, towns, or airport authority, may have been more involved in airport operations and management than a state department.

## 9.5 Chicago Midway International Airport

### 9.5.1 Transaction Background

The proposed long-term lease of Chicago Midway International Airport (Midway) to a private firm was by far the largest proposed airport privatization in the United States

and was posited to be a landmark transaction as the first privatization of a major commercial airport in the United States. In addition, the city of Chicago was the only applicant in the history of the APPP that was able to secure airline approvals for its application, which is needed for the city to use the lease revenues for non-airport purposes.

In 2005, the city secured state legislation to extend the airport's exemption from property taxes to a private owner, which paved the way for the transaction and committed the city to use 90% of the net proceeds to finance infrastructure work or up to 45% of the net proceeds to shore up the city's \$9 billion (at the time) unfunded pension liability. These commitments were needed to secure the support of the powerful Chicago Federation of Labor. In October 2006, the city secured the only large-hub slot under the APPP. In February 2008, the city secured airline approvals for its APPP and immediately issued a request for qualifications (RFQ) for bidders. Bids were received on September 30, 2008 two weeks after Lehman Brothers Holdings collapsed (September 16), which triggered the global credit crisis. When the private consortium was unable to come up with the full up-front rent payment under the lease (purchase price) of \$2.521 billion in April 2009, the deal fell through and the consortium had to pay a \$126-million breakup fee to the city, of which \$75 million had been posted as collateral after city council approved the lease. Since that time, the FAA has granted the city's requests for more time to complete the deal through a series of extensions to maintain its spot in the APPP.

### 9.5.2 Objectives

The city began exploring the privatization of Midway Airport soon after it announced its \$1.83 billion 99-year lease of the Chicago Skyway Toll Bridge System in October 2004, a deal considered the first long-term, major PPP involving an existing asset in the U.S. and which closed in January, 2005. Subsequently, the city entered into a long-term lease on its downtown parking garages in a \$563 million deal which closed in December, 2006. In February, 2009, the City also leased its parking meter system for \$1.15 billion.

The primary motivation for the Midway transaction was to get "value out of the airport" by leasing the airport on a long-term basis to a private operator and using the proceeds for the city's unfunded pension liability, infrastructure improvements, and other general fund purposes.

Also as stated in the February 2008 RFQ, the city's primary objectives were:

Protect the Public Interest

- Maintain the highest levels of public and passenger safety and security
- Protect the public interest within the context of seeking value for the City and the airlines

- Establish a new framework of rates and charges that provides lower and more predictable rates for airlines operating at the Airport
- Improve the competitive position, service quality, growth prospects and efficiency of Midway Airport for the benefit of Chicago residents, airlines and other users

#### Risk Adjusted Value Optimization

- Maximize sale proceeds
- Ensure that future Airport development is safe, functional, efficient and delivered when necessary
- Minimize the City's exposure to residual risks and liabilities from the process

#### Fair and Transparent Process

- Protect the reasonable interests of current and future airline users
- Ensure fair and equitable treatment of existing Airport employees
- Ensure a smooth transition from public to private management in a timely manner

### 9.5.3 Stakeholder Interests

**Airlines.** Under the APPP, in order for the city to apply lease revenues from the transaction for general city purposes, the lease must receive the approval of both 65% of the airlines operating at Midway and airlines representing 65% of the annual landed weight. This provision gave all Midway carriers, especially Southwest with 84.4% of the passenger market share in 2008, considerable bargaining power.

The city and Southwest Airlines negotiated an agreement that would have generated millions of dollars in net present value savings for the airlines serving Midway. The use agreement would have extended through 2033, with five-year renewals afterward. Specifically, the deal won airline approval because it would:

- Cap airline rates and charges at a level below total 2008 charges and freeze rates for the first six years. It should be noted that the residual airline rates that were in effect at that time did not include amortization of principal on the bonds issued to finance the terminal redevelopment. Therefore, the airlines would have been able to lock in very favorable rates before they spiked. Airline CPE ranged from \$3.38–\$7.55 from 2004–2009, with the high occurring in 2009. However, the budgeted CPE in 2010 increased sharply to \$11.39, which had been planned due to the deferral of principal amortization and expiration of the application of Letter of Intent grants to debt service. The airport also projected CPE to increase sharply again in 2011, to \$14.63, but remain near that level through 2018.
- Limit future rate increases to inflation for the remainder of the 25-year use agreement.

- Grant the airlines approval rights for capital improvement costs to be included in airline rates (i.e., the cost of ongoing capital projects would be added to annual airline charges only after airline approval).
- Provide strong operating and service performance standards, including a capital asset maintenance plan, capital improvement program report, and five-year capital improvement program that must be developed on an annual basis by the private operator and submitted to the city and the airlines for approval by the city and a majority-in-interest by the airlines. These reports would define and describe the planned rehabilitation, replacement, and reconstruction capital requirements.
- Transfer the risk of operations and maintenance costs from the airlines to the private operator.
- Give the airlines sign off rights on the bidders' qualifications.

Not only would the transaction have provided the airlines considerable net present value savings (especially in the near term), but it would have also provided stable, predictable rates and charges, which is one of the airlines' biggest concerns.

The airlines also wanted to maintain the Midway Airlines Terminal Consortium (MATCO), which was formed to operate and manage the terminal airline equipment and systems, including pre-conditioned air systems, aircraft ground power-400Hz system, passenger loading bridges, potable water cabinets, baggage handling systems, MUFIDS, battery charging, security checkpoint equipment, and aircraft fueling systems.

**Labor.** The city won the support of unions by ensuring that current employees would be offered jobs with similar pay and benefits in any lease. The city's commitment to use the net proceeds to fund pensions and infrastructure also helped. The Illinois legislation that allowed the city to lease Midway requires the private operator to pay employees "an amount not less than the economic equivalent of the standard of wages and benefits enjoyed by the lessor's employees who previously performed that work." In addition, the private operator and the city must offer employment "under substantially similar terms and conditions" to municipal employees working at the airport. There is also a labor neutrality and card check agreement covering unrepresented workers.<sup>87</sup> It is important to note that the city was willing to

<sup>87</sup>In 2006, the Illinois General Assembly enacted Public Act 94-750, which provides for certain requirements that must be satisfied in connection with the privatization of Midway. These requirements relate to labor relations and employee protections; continued compliance with applicable ordinances governing contracting with minority-owned and women-owned businesses, prohibiting discrimination and requiring appropriate affirmative action; and application of the net proceeds of the privatization by the city.

offer the employees positions elsewhere in city government, which may not be an option in other situations.

**Community.** In order to maintain Midway's property tax-exempt status under private operation, the city had to negotiate with the state legislature. The tax-exempt status was considered necessary for the transaction to be economically viable and as such was a front end activity. In addition to the labor protections noted above, the state legislation also:

- Required that at least 90% of the proceeds from the lease be used for infrastructure construction and maintenance and for contributions to the municipal employee pension funds.
- Prohibited the expansion of any of the Midway runways.<sup>88</sup>

**Potential Bidders.** The city also met several times with potential bidders to learn about their interests and concerns to design a solicitation that met their needs. Through these discussions, it was determined that the city would need to maintain the police and fire functions for Midway to mitigate the risks perceived by the potential bidders.

### 9.5.4 Outcome

The consortium of investors led by Citigroup Inc., a unit of Vancouver International Airport, and John Hancock Life Insurance Co. submitted the highest bid (\$2.521 billion) to lease Midway in September 2008. The winning consortium was called Midway Investment and Development Company LLC (MIDCo). In the context of the global financial crisis, MIDCo was unable to raise the entire purchase price for the lease by the city's deadline in April 2009 and as a result forfeited the \$126 million in earnest money it posted to the city.

People involved with the Midway transaction trumpeted its merits and win-win proposition to all stakeholders. They believe the only reason the transaction failed to reach financial close was due to the collapse of the debt and equity markets. Others have expressed concerns about the precedents set in terms of the amount of the bid proposal of the winning bidder and the favorable provisions in the airline agreement. They fear that other policy makers will expect to realize the same multiples (28 times revenues) and that the airlines will see the Midway lease as the benchmark for future privatization transactions even though the conditions are different for every airport. A number of people have expressed skepticism on the ability for MIDCo to be able to make a profit given the amount of the bid, the rate caps under the airline

use agreement, the relatively well-developed terminal retail program, the operating efficiencies introduced by the city in 2009, the limited potential for land development, and limitations on passenger throughput growth due to the prohibition on runway expansion and lack of land for terminal expansion. A preliminary assessment would suggest that the highly leveraged environment existing before the collapse of the global markets had fueled unrealistic prices and expectations for some underlying assets whose values have since waned.

### 9.5.5 Lessons Learned

This case study has provided some important lessons learned by the stakeholders, including:

- A successful APPP application process requires strong political support and leadership. The city of Chicago had that in Mayor Richard M. Daley. There was also a very supportive administration in Washington, D.C., and there was political momentum from the large bid on the Skyway deal.
- Going through the APPP is lengthy, complex, and time-consuming and can be an expensive process. The rewards to the airport owner can be potentially large, but success is not guaranteed. Any public sponsor should consider the level of effort, expense, and risk before applying.
- Privatizing an airport under the APPP in the United States is far more complicated than privatizing toll roads or parking facilities given the highly regulated environment, complexities involved in operating an airport, the pace of technological changes affecting airports, and the multiple approvals needed, including the FAA, TSA, CFIUS (if the sale or lease of the airport is to a private operator that is a foreign entity<sup>89</sup>), labor, and airlines (if revenue is to be used for non-airport purposes) in addition to the local approval requirements (e.g., city council).
- It is important to include in the airport's privatization team technical advisors given the extensive and complex legal, financial, operational, and regulatory issues involved in the airport industry. The city had very capable external advisors and engaged airport staff productively in the operational issues.
- The goals for the privatization should be clearly articulated. The city's goals were always transparent and well-articulated, which helped eliminate resistance to the transaction.
- It is important to estimate the expected net proceeds early in the process to know if the transaction can yield positive benefits. The city retained financial advisors to run various scenarios to assist it in making the decision to go forward with the transaction.

<sup>88</sup>The airport is located in a densely developed section of the city, including residential development. Also, in December 2005, a Southwest Airlines aircraft slid off a runway at Midway while landing in a snowstorm and crashed into automobile traffic, killing a six-year-old boy.

<sup>89</sup>Due to the lack of airport privatization in the United States most of the potential bidders tend to be global infrastructure specialists.

- The public sponsor needs to get key stakeholders on board early, including labor and airlines, to maximize the potential for success.
- Transparency and public outreach are important. The FAA sets up public dockets that contain valuable information, but local residents often are not aware of this resource. In the case of Midway, where homes are as close as 30 feet from the airport boundary, the local community was very supportive because the local community understood the economic value of the airport.<sup>90</sup>
- Maintaining property tax exemptions under private operation of a long-term lease was important for the economics of the deal or would otherwise need to be reflected in the valuation of the airport.
- Oversight and performance standards were important to include in the operator's concession lease and they were coordinated with the airlines. The operator would be held accountable.
- The length of a lease needs to be considered carefully. Initially it was expected that the Midway lease would be for "50 years or more" as U.S. accounting rules dictate that, for expenses to be deducted by the lessee, the length of the lease needs to equate to the remaining economic life of the asset, and this deal was approved for a term of 99 years to maximize the up-front lease payment to the City. The level of equity investment is tied to the term, which falls off dramatically with shorter terms. On the other hand, with long-term leases it is important to ensure the operator does not neglect the asset in the final years of the lease. This is why the Midway operator was required to prepare a capital asset maintenance plan, capital improvement program report, and five-year capital improvement program each year and submit them to the city and the airlines for approval.
- The city was not in a position to offer tax-exempt financing to the bidders, which is one way to substantially lower the amount of financing needed by private investors (as shown in the JFKIAT case study). This is because in order to qualify for the federal tax exemption, the asset must be governmentally owned, which means the term of the lease cannot be greater than 80% of the useful life of the asset. As noted above, privatization models push for longer terms. In addition, under IRS regulations, tax-exempt bonds cannot be used to acquire existing assets unless at least 15% of the proceeds are used for rehabilitation expenditures for buildings associated with the property.<sup>91</sup>
- Privatization through the APPP is not a solution for every airport. It was attempted by the City of Chicago because it

allowed for the net proceeds paid up-front under the lease to be used off-airport. However, and as best expressed by Amy Weaver of Southwest Airlines who participated in the Midway transaction,

The APPP outlines a practical, effective process for privatization. Airports, airlines and any other players need to remember that each privatization deal is unique . . . The pilot program is flexible enough to accommodate . . . unique qualities.<sup>92</sup>

One of the reasons the airline rates could be frozen for the first six years at Midway was because the city had just completed a major terminal redevelopment program and the APPP rules provide airlines with negotiating leverage.

## 9.6 Morristown Municipal Airport

### 9.6.1 Transaction Background

Morristown Municipal Airport (MMU) is a general aviation airport that is owned by the Town of Morristown and has been managed and developed by DM AIRPORTS, LTD. (DM), an affiliate of the DeMatteis Organizations, since 1982 under a comprehensive long-term lease.

The airport is located in Hanover Township in Northern New Jersey in close proximity to New York City. MMU provides services for businesses located in Morris County where approximately 50 of the nation's Fortune 500 companies are either headquartered or have major facilities. As a result, MMU has a significant number of high-end users at the airport and competes primarily with Teterboro Airport and Westchester County Airport for business. Therefore, DM is highly incentivized to provide strong customer service at reasonable prices to its clientele and offers special aviation enhancements.

The Agreement of Lease between the town and DM was entered into in December 1981 with a term of 99 years commencing on May 1, 1982 and extending through April 30, 2081. Under the long-term lease, the town granted the full management and development control of the airport to DM in return for DM (1) paying annual rent to the town, (2) paying all outstanding airport debt service when due, and (3) undertaking all capital improvements. As such, DM has wide discretion and is responsible for making decisions regarding the development of MMU (i.e., capital improvement projects) and managing its operation, which includes among other things, negotiating leases, handling staff and services, and setting rates, fees, and charges. The only residual airport controls retained by the town are the signing of

<sup>90</sup>Interview with Erin O'Donnell, Managing Deputy Commissioner of Chicago Midway International, September 20, 2010.

<sup>91</sup>26 USC 147—Sec. 147. Other requirements applicable to certain private activity bonds.

<sup>92</sup>Amy Weaver, *Southwest Airlines says Midway indicates privatization can fly in the United States*, HNTB Aviation Insight, Spring 2010.

airport grants and approval of site plans, but the town is obligated to mutually cooperate with DM in securing such approvals. DM retains all revenues derived from its operation of the airport.

The 99-year term of the lease was deemed necessary for DM to recover its payment of the town's outstanding airport debt and its investment in upgrading existing facilities and constructing new ones. DM also has responsibility for all airport repairs, maintenance, and operations (except police services which are provided by the town) and compliance with all governmental regulations. In addition, DM is responsible for obtaining at its own cost all site plan approvals and zoning approvals and permits for airport development with the full cooperation of the town.

The lease gives DM great flexibility in carrying out its charge of operating the airport as a public airport subject to all applicable laws, regulations and agreements, including compliance with FAA grant assurances.

The lease also gives DM the right to mortgage all or any portion of its interest in the lease (without the town's consent) to obtain the most favorable financing needed for airport development. In addition, the lease is assignable "without restriction of any kind."

Airport users pay fees and charges directly to DM and DM assumes the risk involved in covering both operating and capital costs out of those revenues.

It is important to note that the Morristown privatization occurred before the FAA promulgated its revenue use policy and before the creation of the APPP. Therefore, it is not reasonable to expect to be able to repeat this experience because the federal rules are much stricter now. Nevertheless, the lease served as a model for the Stewart lease under the APPP.

## 9.6.2 Objectives

In 1981, after operating the airport unprofitably for many years, the town had accumulated over \$2 million in debt for airport capital improvements even though its infrastructure was in a state of disarray. The airport's corporate users were threatening to leave because the airport and the FAA was threatening to close the facility if upgrades were not made. The town recognized it did not have the talent on staff to run the airport properly and looked to a private company to operate and manage it on their behalf, pay off the debt, and make the necessary capital improvements to appease the FAA and tenants. After careful consideration, the town concluded that the airport could be better operated and developed by a private entity. The town studied various proposals and considered several potential developers to run the airport.

Therefore, the primary objectives in the MMU privatization were to:

- Pay off \$2 million in airport long-term debt.
- Make substantial upgrades to the airport's infrastructure with the aid of federal and state grants, which was in a state of disarray.
- Turn the airport into an economic catalyst for the town and the region.

## 9.6.3 Stakeholder Interests

**Labor.** When DM took over operation of the airport in 1981, there were approximately 35 employees on the airport payroll. The maintenance and operations staff was offered positions by DM, but most of the senior employees moved to positions within the town government to maintain their municipal status and pension benefits.

**Local Government.** The management contract has served the Town of Morristown well. The town's only responsibilities for the airport are police protection, emergency medical response, grant administration and audits, and site plan approvals. DM converted a facility in a state of disrepair into an economic engine by investing in the airport's infrastructure and providing a high level of service to the users. This arrangement has also worked well for Hanover Township, where the airport is located, because DM must pay land taxes to the township unlike a municipal operator.

**Community.** DM is responsible for all interactions with the community with regard to the airport. Morris County views MMU as a critical community asset for retaining and attracting business. Therefore, the Morris County Freeholders<sup>93</sup> established an Airport Advisory Committee in 2003 to interact with DM and MMU tenants, which meets on a bi-monthly basis (but only if there is business to discuss). Although this committee has no jurisdiction over the airport or DM, it has been instrumental in bringing together residents, pilots, government officials, and airport personnel to address noise issues at MMU, among other issues. It also helps DM to build goodwill with the community.

**Tenants.** DM also actively engages airport tenants through various channels. The Morristown Aviation Association (MAA) is an association of mostly airport tenants and some transients that was established to provide a forum for tenant interaction. DM jointly sponsors a periodic publication on airport updates with the MAA and the Morristown Airport Pilots Association.

<sup>93</sup>In New Jersey, county legislators are called "Freeholders."

MMU also has U.S. Customs and Border Protection services for international flights. Because MMU does not have sufficient volume to justify a federal agent being assigned to the airport, the tenants decided to set up a user fee association to pay for one. DM administers the user fee service on behalf of the Morristown Airport Customs Association. Tenants and transients pay to clear with higher rates for transients and non-members. Entities who clear frequently often become a member of the Association.

The tenants also decided they wanted ARFF even though MMU is not a Part 139 airport<sup>94</sup> and ARFF is not required because of the high-end aircraft they use. Like customs, ARFF is not a cost responsibility of DM, but instead is funded by a surcharge on fuel flowage per gallon. However, DM puts out to bid and administers the ARFF contract. The FAA funded 95% of the cost of the ARFF station through an AIP grant as well as 95% of the cost of the first ARFF vehicle (up to Index A). The tenants paid for the cost of a second vehicle through the fuel flowage surcharge because the FAA said it would not support an Index B service.

#### 9.6.4 Outcome

DM initially entered into the long-term lease for the airport based on the potential for commercial development on and around the airport. DM had plans to develop property for commercial, hotel, office, industrial and/or manufacturing purposes. However, subsequently, wetland limitations and the taking of 11 acres of airport property for expansion of Route 24 eliminated the expected potential for commercial land development.<sup>95</sup> Although DM had the option to terminate the long-term lease due to this land taking, it concluded that it could continue to successfully operate the airport without this developable property.

DM paid off the airport long-term debt, made substantial upgrades to the airport with the aid of federal and state grants, and turned the airport into an economic catalyst for the town and the region.

Over the first 28 years of operations (1982—2010), DM has:

- Implemented capital improvements and provided the necessary facilities and services to meet aviation market demand
- Improved customer service at the airport by providing superior facilities and services at competitive rates

<sup>94</sup>Although not required, some large GA airports do have 139 certificates, which greatly affects staffing and operating expenses.

<sup>95</sup>As a result of the land taking, DM's annual base rent was abated slightly. In addition, there was a negotiated settlement on the value of the land that was taken, which was shared approximately 80% by the town and 20% by DM.

- Helped organize, manage, and participate in tenant customer service programs (e.g., the U.S. Customs and Border Protection and ARFF services)
- Marketed the airport's desirable location and high-end facilities to retain and attract customers for the benefit of the local economy
- Transformed MMU into a financially self-sustaining, competitive facility for the region
- Elevated MMU's position to be one of the two premier general aviation airports in northern New Jersey, with Teterboro as the other
- Fostered strong community relations by promoting the airport and engaging its tenants, the Morris County Freeholders, the local chamber of commerce, and other stakeholders
- Established a corporate identity for the airport through participation in aviation trade association events and conferences and marketing efforts, including its user friendly website
- Turned MMU into an economic engine for the town and the region

By contrast, as noted earlier, under the town's operation, the FAA was threatening to shut the airport down due to its state of disrepair.

#### 9.6.5 Lessons Learned

The case study for MMU provides helpful background for any airport considering full privatization outside the APPP, in particular for a general aviation airport. However, it should be noted that the 99-year lease was entered into before the FAA formalized much of its policy regarding airport revenue use and full privatization outside the APPP.

- The MMU long-term lease did not require any special federal or state legislation (such as the APPP).
- However, like the JFKIAT Terminal 4 project, there appear to be special circumstances that make the MMU experiment successful, in particular the demand for high-end general aviation users. Although DM has been approached by several other airports, DM has declined these offers because the market was not there for a viable business opportunity, suggesting that the business climate in Morristown is somewhat unique.
- The DeMatteis Organizations learned that once a professional staff was in place and successfully operating the airport it was no longer necessary to contract out the airport management and therefore was able to save money by no longer having to pay the annual management fee.
- According to DM, privatization allows for a more efficient and effective way to operate the airport. Decisions can be



made in a timely manner. Moreover, bureaucracy, politics, and competing funding priorities do not factor into the business decisions. Unlike the Indianapolis management contract, DM is not required to adhere to local municipal procurement regulations, which allows for greater operating efficiencies and speedier delivery of services.

- Due to the nature of the agreement (in particular its term and development responsibilities), DM pays land and improvement taxes to Hanover Township. Typically, public airport owners/operators do not pay property taxes. Therefore, this type of privatization allows a local municipality (other than the owner) to derive incremental tax revenues.
  - Community outreach is important for airports. Although not mandated in the lease, DM actively and successfully engages the community and its tenants. This is an area for possible improvement in a lease in the event the lessee was not as committed to the airport and its rapport with the community.
  - The lease does not include specific oversight and performance standards. This would typically be included in a long-term lease or management contract of this type. However, given the competitive nature of high-end general aviation use in the New York metropolitan area, DM is incentivized to provide a high level product.
  - The term of a long-term agreement, where the public sponsor grants full management and development control to the operator in return for the operator undertaking full capital improvements, needs to be considered carefully. Where significant airport development is anticipated, the term of the lease should be related to the length of time needed by the operator to recover its investment. In this case it was felt that a 99-year lease was needed due to DM's obligation to defease the \$2 million in outstanding airport debt and make the necessary improvements to the airport. Whether a 99-year lease is necessary or appropriate for a similar deal should be carefully considered. DM pays a relatively modest annual rent for the privilege of retaining all airport fees and charges in return for taking on the risk to cover operating expenses and capital expenditures (net of grants) out of those revenues.
  - The form of compensation—upfront lump sum versus annual rent—is also something to be carefully considered and evaluated. The town decided to take the annual rent to cover its cost to provide continuing police, emergency medical, and grant administration services for the airport. By comparison, the city of Chicago opted for an upfront payment and set aside funds for its ongoing obligation to provide police and fire protection for Midway Airport.
  - The lease does not have definable requirements for maintaining the airport other than “maintain the Airport in reasonably good operating condition subject to deterioration caused by wear and tear” and there is no obligation to set aside funds towards the end of its term to make sure the asset is in good condition when the lease expires. For example, under the proposed 99-year Midway lease the operator was required to prepare a capital asset maintenance plan, capital improvement program report, and five-year capital improvement program each year and submit them to the city and the airlines for approval. While DM has done a good job maintaining the airport after 28 years of stewardship, there could be stronger requirements in the lease about maintaining the airport in the later years of the term.
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## APPENDIX A

## Abbreviations and Acronyms

AAIA	Airport and Airway Improvement Act of 1982
AATF	Airport and Airway Trust Fund
ACRP	Airport Cooperative Research Program
AHTA	Anti-Head Tax Act
AIP	Airport Improvement Program
AMT	Alternative Minimum Tax
APPP	Airport Privatization Pilot Program
ARFF	Aircraft Rescue and Firefighting
ARRA	American Recovery and Reinvestment Act
BABs	Build America Bonds
BOT	Build-Operate-Transfer
BTO	Build-Transfer-Operate
CapEx	Capital Expenditures
CFIUS	Committee on Foreign Investment in the United States
CFR	Code of Federal Regulations
CM at risk	Construction Manager at Risk
CPI	Consumer Price Index
DBOM	Design-Build-Operate-Maintain
DBOM/F	Design-Build-Operate-Maintain and Finance
DBOT	Design-Build-Operate-Transfer
DOJ	U.S. Department of Justice
EBITDA	Earnings Before Interest, Tax, Depreciation, and Amortization
FAA	Federal Aviation Administration
FBO	Fixed-Base Operator
GA	General Aviation
GAO	General Accounting Office, now the General Accountability Office
HVAC	Heating, Ventilation, and Air Conditioning
NYS DOT	New York State Department of Transportation
OpEx	Operating Expenditures
PFCs	Passenger Facility Charges
RAB	Regulatory Asset Base
RFP	Request for Proposal
SWFAA	SWF Airport Acquisition, Inc.
TSA	Transportation Security Administration
U.S. DOT	U.S. Department of Transportation

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## APPENDIX B

# Glossary of Privatization Terms

**63-20 financing:** The issuance of tax-exempt bonds by nonprofit entities to finance tangible public assets pursuant to IRS revenue ruling 63-20 of 1963, typically under long-term leases. For example, the 63-20 financing structure has been used to build hospitals, toll roads/bridges, university buildings, city halls, water and sewage facilities, hotels, and convention centers.

**Aeronautical:** Aeronautical use includes services provided by air carriers related directly and substantially to the movement of passengers, baggage, mail, and cargo on the airport and any activity which involves, makes possible, or is required for the operation of aircraft, or which contributes to or is required for the safety of such operations.

**Airport and Airway Trust Fund (AATF):** A fund established by the Airport and Airway Revenue Act of 1970 (the Act) that provides the revenues used to fund AIP projects and the administration of AIP. The Act, as amended, authorizes the use of funds from the AATF to make grants under AIP on a fiscal year basis. The U.S. Congress authorizes obligation authority to distribute AATF revenues to U.S. airports. Revenues for the AATF are derived from passenger ticket taxes and other excise taxes. The AATF provides multiyear capital for aviation system infrastructure such as facilities and equipment (F&E) and AIP and has helped fuel predictable growth in aviation infrastructure. Because the AATF is funded with user money, it keeps reliance on taxpayers to a minimum.

**Airport Compliance Manual:** Order 5190.6B that was released in September 2006, which sets forth policies and procedures for the FAA Airport Compliance Program. It provides basic guidance for FAA personnel in interpreting and administering the various continuing commitments airport owners make to the United States as a condition for the grant of federal funds or the conveyance of federal property for airport purposes. Order 5190.6B discusses the obligations set forth in the standard airport sponsor assurances, addresses the application

of the assurances in the operation of public-use airports, and facilitates interpretation of the assurances by FAA personnel.

**Airport Improvement Program (AIP):** The federal grants-in-aid program that provides grants to public agencies—and, in some cases, to private owners and entities—for the planning and development of public use airports that are included in the National Plan of Integrated Airport Systems (NPIAS). Eligible projects include those improvements related to enhancing airport safety, capacity, security, and environmental concerns. For large and medium primary hub airports, the grant covers 75% of eligible costs (or 80% for noise program implementation). For small primary, reliever, and general aviation airports, the grant covers 95% of eligible costs.

**AIP Entitlement Grants:** AIP funds that must be apportioned by formula each year to specific airport sponsors, types of airports, or states under statutory provisions.

**AIP Discretionary Grants:** AIP funds remaining after entitlement funds are determined. FAA approves discretionary funds for use on specific projects after consideration of project priority and other selection criteria. The FAA allocates discretionary funds to high priority project needs in a manner that best advances statutory goals and objectives to enhance the national airport system. Investment decisions are made using structured selection criteria that include a variety of factors that help identify critical annual development needs within associated AIP funding levels.

**Airport Master Plan:** A long-range plan for development of an airport, including descriptions of the data and alternative analyses on which the plan is based.

**Airport Privatization:** In its generic form, airport privatization can mean any one of the various strategies described above, meaning a broad range of arrangements under which activities once performed by government are to varying degrees turned over to private entities.

**Airport Privatization Pilot Program or APPP:** A program under the category of long-term lease or sale called the Airport Privatization Pilot Program (49 U.S.C. Section 47134), which was enacted by the U.S. Congress in 1996 and amended in 2003 and 2012 to allow up to five airports to be leased or sold under specific conditions as approved by the Secretary of Transportation. The APPP was created to address barriers to privatization in the United States by permitting the U.S.DOT to grant exemptions from certain federal obligations that historically discouraged full privatization by requiring the airport owner and private operators to satisfy rigorous conditions in exchange for the exemptions and approvals.

**Airport Sponsor:** A public agency or tax-supported organization, such as an airport authority, city, county, state or federal government, that is authorized to own and operate an airport, to obtain property interests, to obtain funds, and to be legally, financially, and otherwise able to meet all applicable requirements of the current laws and regulations.

**Amortization:** The repayment of principal, through scheduled mortgage payments. The scheduled payment, less the interest, equals amortization.

**Anti-Head Tax Act or AHTA:** The act passed in 1973 (49 USC Section 40116) that allows a publicly owned airport authority to collect only reasonable landing fees and charges from airlines using airport facilities.

**Build America Bonds or BABs:** State or local governmental bonds that could be issued as tax-exempt bonds, but which the issuer elects to treat as BABs. Interest on BABs is taxable to the bondholder, but a federal income tax credit (of 35% of the interest paid on the bond in each tax year) is provided in lieu of the tax exemption. BABs were included in the American Recovery and Reinvestment Act of 2009 and were available for bonds issued between February 17, 2009 and December 31, 2010.

**Build-Operate-Transfer (BOT):** An approach where the private partner builds a facility to the specifications set by the airport owner, operates the facility for a specified time period, and then transfers the facility to the agency at the end of the contract. In most cases, the private partner will also provide some, or all, of the financing for the facility. Therefore, the term of the contract must be sufficient to enable the private partner to realize a reasonable return on its investment through user fees.

**Build-Transfer-Operate (BTO):** An approach that is similar to the BOT model except that the transfer to the airport owner takes place at the time construction is completed, rather than at the end of the lease period.

**Building Blocks:** Within a CPI-X approach to regulation, a methodology where costs are defined as operating costs, and return of and on capital.

**CapEx:** Capital expenditures.

**Claw Back:** A feature of regulation where excess profits made in one regulatory period are recovered by the regulator in the subsequent period.

**Commercialization:** Refers to the application of business-like approaches to the management and operation of airports by shifting aviation management and operations from government department to a business-focused entity to allow market forces, incentives, and mechanisms drive the delivery of services. It is a shift in management not ownership of the airport.

**Committee on Foreign Investment in the United States (CFIUS):** The inter-agency committee of the U.S. government that reviews the national security implications of foreign investments in U.S. companies or operations. Chaired by the Secretary of the Treasury, CFIUS includes representatives from 16 U.S. departments and agencies, including the Commerce, Defense, Homeland Security, and State departments.

**Concession:** Contract to transfer rights to manage and/or operate a property for a certain period, usually without property rights.

**Consumer Price Index (CPI):** Measures inflation by calculating the change in price of a “fixed market basket of goods and services,” purchased by a specified population during a “base” period of time. CPI bears little direct relationship to actual costs of building operation or the value of real estate, but is commonly used to increase the base rental periodically, as a means of protecting the landlord’s rental stream against inflation, in lieu of the landlord undertaking the record keeping necessary to determine the true change in operating expenses.

**Construction Manager at Risk (CM at risk):** A project delivery method where the construction manager commits to deliver the project within a Guaranteed Maximum Price (GMP). The construction manager acts as consultant to the airport owner in the development and design phases and as a general contractor during the construction phase. Due to the financial commitment, the CM at risk has an incentive to manage and control construction costs to not exceed the GMP.

**Corporatization:** The process by which an airport previously subsumed within a government agency is transformed into a government-controlled corporation in order to introduce corporate management culture and efficiency.

**Cost Per Enplanement (CPE):** A standard metric in the United States to compare total airline payments (including landing fees and terminal rentals) expressed on a per enplaned passenger basis.

**Contracting Services or Outsourcing:** Airport owners routinely contract out to the private sector certain airport services traditionally provided by government or internal employees in order to (1) achieve operating efficiencies through outsourcing the operation of functions that readily are available through the private sector (e.g., janitorial, escalator/elevator repair, non-police security, parking operations), (2) enhance nonairline revenue (e.g., terminal concessions), or (3) provide project design and delivery (e.g., construction management and program management) for capital improvements.

**Commercial Service Airports:** Public airports receiving scheduled passenger service and having 2,500 or more enplaned passengers (also referred to as boardings) per year. There were 501 commercial service airports in calendar year 2010.

**CPI-X:** A regulatory regime in which aeronautical prices increase by inflation (the consumer price index) less a specified percentage (X).

**Customer Facility Charge (CFC):** A rental car Customer Facility Charge (CFC) is a per transaction day, or a per transaction, charge imposed on the rental car customer by the airport, collected by the rental car companies, and remitted by the rental car companies to the airport. Imposition of a CFC has been key to the financing of consolidated rental car facilities.

**Depreciation:** Spreading out the cost of a capital asset over its estimated useful life or a decrease in the usefulness, and therefore value, of real property improvements or other assets caused by deterioration or obsolescence.

**Design-Build-Operate-Maintain (DBOM):** An approach where a single contractor is responsible for designing, constructing, operating, and maintaining a facility with financing secured by the airport owner. The owner maintains ownership and retains a significant level of oversight of the operations (as set forth in the contract). Under this model the risk for construction cost overruns and responsibility for annual operating expenses belongs to the private contractor.

**Design-Build-Operate-Maintain and Finance (DBOM/F):** An approach where the contractor also is responsible for financing the project. Most examples of airport project finance transactions in the U.S. involve special purpose facilities for single or multi-tenant use, typically an airline, one or more cargo tenants, or rental car companies. The revenues from such special purpose facilities are pledged to pay debt service on the obligations incurred for such special purpose facilities

and are not included in general airport revenues. Project finance is also used on behalf of private, third parties that are not tenants of the facilities

**Design-Build-Operate-Transfer (DBOT):** An approach where a private partner designs, constructs, and operates a facility and hands over ownership of the facility to the airport owner after operating it for a specified period of time. Under this model the responsibility for construction cost overruns and annual operating expenses belongs to the private contractor.

**Developer Financing:** A form of project financing, but is distinguished by the private sector also putting its own equity capital at risk as well as managing and operating the facility.

**Dual till:** An approach to regulation of aeronautical charges where the level of charges is set to recover aeronautical costs only.

**Earnest Money:** The monetary advance, by a buyer, of a portion of the purchase price in a real estate transaction, to indicate the intention and ability of the buyer to carry out the contract.

**EBITDA multiple:** The implied enterprise value divided by the airport's EBITDA (earnings before interest, tax, and depreciation). It should be noted that in some cases this multiple is specified publicly for a sale even though the assumptions on EBITDA and Enterprise Value are not themselves directly stated.

**FAA Order 5190.6B:** The order released in September 2010 also called the Airport Compliance Manual, which sets forth policies and procedures for the FAA Airport Compliance Program. It provides basic guidance for FAA personnel in interpreting and administering the various continuing commitments airport owners make to the United States as a condition for the grant of federal funds or the conveyance of federal property for airport purposes. Order 5190.6B discusses the obligations set forth in the standard airport sponsor assurances, addresses the application of the assurances in the operation of public-use airports, and facilitates interpretation of the assurances by FAA personnel.

**Fair Market Value (FMV):** The sale price at which a property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of the relevant facts.

**Federal Aviation Administration (FAA):** The United States government agency responsible for ensuring the safe and efficient use of the nation's airports and airspace.

**Federal Aviation Regulation (FAR):** Regulations established by the Federal Aviation Administration (FAA) to govern the operation of aircraft, airways, and airmen.

**Fee Simple Ownership:** The full purchase of land and improvements.

**Fixed Base Operator (FBO):** Provides aviation services to the general public, including, but not limited to, the sale of fuel and oil; aircraft sales, rental, maintenance, and repair; parking and tie-down or storage of aircraft; flight training; air taxi/charter operations; and specialty services such as instrument and avionics maintenance, painting, overhaul, aerial application, aerial photography, aerial hoists, and pipeline patrol.

**Freehold sale:** An estate in land, a form of fee simple ownership.

**Full Privatization:** Full privatization refers to strategies where the full control and/or operation of an entire airport are vested with a private entity, including the long-term lease or sale, whether through the APPP or otherwise. As noted above, APPP is a program under which a long-term lease or sale can occur with full control vested in the private operator except for certain residual powers retained by the airport owner.

**General Aviation (GA):** That portion of civil aviation that encompasses all facets of aviation, except air carriers.

**Golden share:** A share held usually by government without economic value which conveys defined voting rights over airport strategic and other decisions.

**Gold plating:** A perceived problem of systems of economic regulation that incentivize over-investment.

**Governmental Bonds or non-AMT Bonds:** Bonds as defined in Section 141 of the Code where interest is fully free of taxation for bondholders.

**Grant Assurances:** Obligations attached to FAA administered airport financial assistance programs that require the recipients to maintain and operate their facilities safely and efficiently and in accordance with specified conditions.

**Heavy handed regulation:** An approach to regulation of aeronautical charges where price approval is set with maximum regulatory intervention.

**Hybrid till:** An approach to regulation of aeronautical charges where the level of charges is set to recover aeronautical costs less a subsidy from the profits of non-aeronautical activities.

**Financial Investors:** Providers of equity, including private equity funds, infrastructure funds, and pension funds.

**Lease:** An agreement whereby the owner of real property (landlord or lessor) gives the right of possession to another (tenant or lessee) for a specified period of time (term) and for a specified consideration (rent).

**Lease Term:** A fixed, noncancelable period of time for which a lease agreement is in force. This terminology refers to the lease period.

**Lenders:** Providers of debt financing to support an acquisition or as ongoing lenders, including lending bankers, infrastructure funds, and the bond market. Many airports are financed by a mix of equity, bank debt, and bond debt.

**Light Handed Regulation:** An approach to regulation of aeronautical charges where price approval is set with minimal regulatory intervention, potentially through reserve powers regulation. Reserve powers regulation is an approach to regulation of aeronautical charges where price approval is set by agreement between airports and airlines, with an independent regulator deployed if agreement is not reached.

**Long-term Lease or Sale:** A long-term lease, long-term concession, sale, or other transfer of an entire airport to private operation and/or ownership (e.g., BAA in the United Kingdom, Australian airports).

**Management Contract:** An approach where a private entity manages an airport or certain airport facilities for a specified period of time and typically provides little or no capital investment. The private manager's objective is to improve the financial and operational efficiency of the facility for which the manager is paid a fee and is reimbursed for its expenses, subject to a budget that is usually set by the manager and approved by the airport owner. Most airports operate their public parking facilities using a management contract, and some use a management contract for the operation of individual terminals or master terminal concessions, hangars, warehouses, or, in a few cases, for their entire airport.

**Master Terminal Concession Developer:** An approach where the developer acts as the airport owner's master lessee and is responsible for developing and managing terminal concession and retail activities, including merchandising, retail, food and beverage, and sometimes advertising services. Typically, the concession developer is not authorized to operate terminal concessions except in the case of a vacancy. The airport owner and developer share in the revenues under various formulas. Often the developer is required to contribute to a repair and replacement fund to cover certain repair and replacement costs.

**National Plan of Integrated Airport Systems (NPIAS):** A document that is prepared and published every 2 years by the FAA, which identifies public-use airports that are important to public transportation and contribute to the needs of civil aviation, national defense, and the Postal Service. Airports under the NPIAS are eligible for AIP grants.



**Non-aeronautical:** Uses and services that are not related to the movement of aircraft, passengers, baggage, mail, and cargo.

**Nonprimary Airports:** Airports with less than 10,000 annual passenger enplanements (boardings), of which there were 125 in calendar year 2010.

**Outsourcing:** The delegation of operations from the public sector to a private entity that specializes in the operation, maintenance, or management of that activity.

**Parking Concession Agreements:** An approach where the private operator is typically responsible for all aspects of day-to-day parking operations, including shuttle buses, facility maintenance, and fee collections. As payment for their services, the concessionaire receives a percentage of the gross revenues from parking operations, but is required to pay the greater of this percentage amount or a minimum annual guaranteed amount to the airport owner. Therefore, the concessionaire assumes most of the risk for potential downturns in parking revenues, but also receives greater rewards if there is an unexpected increase in airline passenger traffic.

**Partial Privatization:** Partial privatization refers to all other strategies where partial control and full ownership of an airport remains vested with the public owner.

**Passenger Facility Charges (PFCs):** A charge per eligible enplaned passenger in the United States authorized by 49 U.S.C. 40117 and regulated by 14 CFR Part 158 for FAA-approved capital improvements. PFCs are an exemption from the Anti-Head Tax Act.

**Primary Airports:** Airports with more than 10,000 annual passenger enplanements (boardings), of which there were 375 in calendar year 2010.

**Private Airport Operators:** Participants in full airport privatization that do not have an equity interest in the transaction but operate the facility.

**Private Activity Bonds or AMT Bonds:** Bonds that are generally excluded from taxable income of the holder, is an item of tax preference under the alternative minimum tax provisions of Section 142 of the Internal Revenue Code of 1986 (as amended) and the Treasury Regulations. AMT Bonds are issued for facilities that will have excessive use by private users (e.g., terminal buildings).

**Private Airport Development:** Development of an entire airport without the aid of federal or state grants by private investors to be operated as a for-profit business. It should be noted that private airport development without government support is not considered to be airport privatization for purposes of the guidebook since it does not involve the transfer

of control or ownership from the public sector to the private sector. For example, Branson Airport, which was developed without government funding, is not considered a form of airport privatization.

**Project Financing:** Project financing is the most common way to channel private sector investment into public sector infrastructure. Money is borrowed (often through a tax-exempt conduit issuer of municipal bonds) for the specific purpose of financing a project, and lenders are repaid only from the cash flow generated by the project or, in the event the project fails, in some cases, from the value of the project assets. Thus, if project revenues never materialize because the project is abandoned during construction or if project revenues are disrupted because of operational problems, there is no alternative source of cash flow to meet debt service requirements. Most examples of airport project finance transactions in the United States involve special purpose facilities for single or multi-tenant use, typically an airline (e.g., unit passenger terminal, terminal equipment, or fuel storage and distribution systems), one or more cargo tenants (cargo buildings), or rental car companies (consolidated rental car facilities).

**Public-Private Partnerships or PPP or P3:** P3s are strategies in which a public agency (federal, state, or municipal) grants a private entity the right to design, build, maintain, operate, or finance airport infrastructure (e.g., terminal building, cargo building, entire airport) for a contracted period while the public agency maintains rights or obligations during the contract period and maintains ownership of the asset. PPPs can confer a wide range of options in terms of capital allocation and respective levels of participation, ranging from a design/build contracting process to innovative approaches where a private operator takes charge of the construction, financing, and management of an asset over a long-term concession.

**Public-use Airport:** An airport open to the public that also meets the following criteria: (1) publicly owned, (2) privately owned but designated by FAA as a reliever, or (3) privately owned but having scheduled service and at least 2,500 annual enplanements.

**OpEx:** Operating expenses.

**Regulatory Asset Base (RAB):** The investment base upon which the operator is permitted to earn a reasonable return.

**Surplus Property Act:** An act of the U.S. Congress enacted October 3, 1944 to provide for the disposal of surplus government property to “a State, political subdivision of a State, or tax-supported organization” that puts limitations on the sale, lease, encumbrance, transfer, or disposal of any part of the airport owner’s title or other interests in such property.

**Tax-Exempt Debt:** Instruments such as governmental bonds, private activity bonds, and other debt obligations, which are exempt from certain federal taxes and sometimes state taxes. Interest on “Private Activity Bonds” or “AMT Bonds,” although generally excluded from taxable income of the holder, is an item of tax preference under the alternative minimum tax provisions of Section 142 of the Internal Revenue Code of 1986 (as amended) and the Treasury Regulations. Interest on “Governmental Bonds” or “non-AMT Bonds” as defined in Section 141 of the Code is fully free of taxation for bondholders. AMT Bonds are issued for facilities that will have excessive use by private users (e.g.,

terminal buildings). Non-AMT Bonds are used for facilities that do not have an excessive level of use by private users (e.g., roadways and sometimes parking and airfield facilities). The federal subsidies for AMT and non-AMT bonds result in lower interest costs on long-term debt, which provide a comparative advantage for public entities financing infrastructure improvements.

**Vision 100–Century of Aviation Reauthorization Act (Vision 100):** Public Law (P.L.) 108-176, which authorized obligation authority for AIP for federal fiscal years 2004 through 2008.

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## APPENDICES C THROUGH H

Appendices C through H, as submitted by the research agency, are available on the accompanying CD. Their titles are as follows:

- C. International Airport Privatization, Lessons Learned, and Transaction Summaries
  - D. Non-Airport Privatization in the U.S. Transport Sector
  - E. Emerging Domestic Issues Influencing U.S. Airport Privatization
  - F. U.S. Regulatory and Policy Framework
  - G. Key Stakeholder Interests and Concerns
  - H. Detailed Case Studies
-

*Abbreviations and acronyms used without definitions in TRB publications:*

AAAE	American Association of Airport Executives
AASHO	American Association of State Highway Officials
AASHTO	American Association of State Highway and Transportation Officials
ACI-NA	Airports Council International-North America
ACRP	Airport Cooperative Research Program
ADA	Americans with Disabilities Act
APTA	American Public Transportation Association
ASCE	American Society of Civil Engineers
ASME	American Society of Mechanical Engineers
ASTM	American Society for Testing and Materials
ATA	American Trucking Associations
CTAA	Community Transportation Association of America
CTBSSP	Commercial Truck and Bus Safety Synthesis Program
DHS	Department of Homeland Security
DOE	Department of Energy
EPA	Environmental Protection Agency
FAA	Federal Aviation Administration
FHWA	Federal Highway Administration
FMCSA	Federal Motor Carrier Safety Administration
FRA	Federal Railroad Administration
FTA	Federal Transit Administration
HMCRP	Hazardous Materials Cooperative Research Program
IEEE	Institute of Electrical and Electronics Engineers
ISTEA	Intermodal Surface Transportation Efficiency Act of 1991
ITE	Institute of Transportation Engineers
NASA	National Aeronautics and Space Administration
NASAO	National Association of State Aviation Officials
NCFRP	National Cooperative Freight Research Program
NCHRP	National Cooperative Highway Research Program
NHTSA	National Highway Traffic Safety Administration
NTSB	National Transportation Safety Board
PHMSA	Pipeline and Hazardous Materials Safety Administration
RITA	Research and Innovative Technology Administration
SAE	Society of Automotive Engineers
SAFETEA-LU	Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (2005)
TCRP	Transit Cooperative Research Program
TEA-21	Transportation Equity Act for the 21st Century (1998)
TRB	Transportation Research Board
TSA	Transportation Security Administration
U.S.DOT	United States Department of Transportation

## **Appendix C**

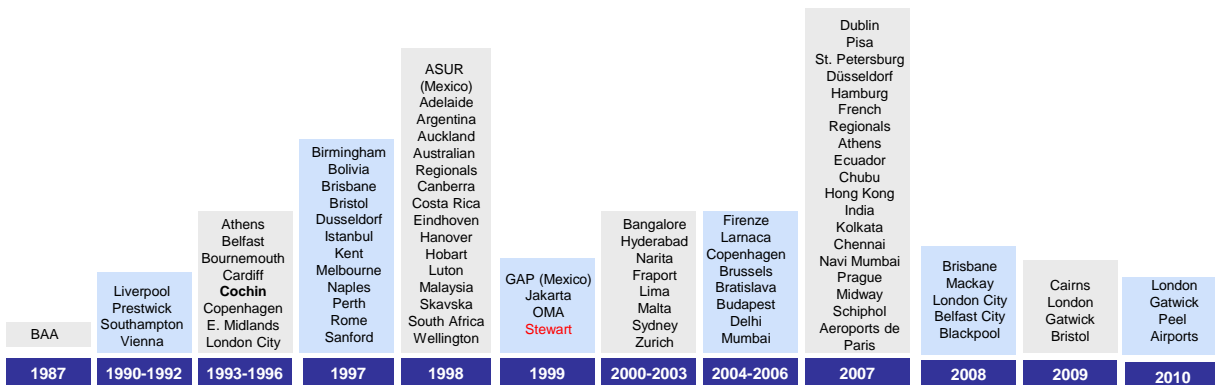
### **International Airport Privatization, Lessons Learned, and Transaction Summaries**

#### **C.1 Context and History**

Full airport privatization has been much more extensive outside the U.S. and there is a significant body of information to be learned from these experiences. However, not much of it is transferable to the U.S. given the regulatory, finance, and legal framework in the U.S. as described in Chapter 3 of the guidebook. Unlike in the U.S., international airport privatization often means the full or partial transfer of airport ownership from the public sector to the private sector through very long-term leases or concessions, an outright sale, or initial public offerings (IPOs). This transfer of control and/or ownership is often accompanied by requirements to improve the airport’s infrastructure and service levels and provide new capacity to keep pace with demand under a regulatory framework for aeronautical charges.

Since the privatization of the UK airports in 1987, over a hundred airports have been privatized worldwide as illustrated in Figure C.1. By contrast, only one airport in the U.S. was fully privatized - Stewart in 1999 – which has since reverted to public operation.

Figure C.1  
**24-YEAR HISTORY OF WORLDWIDE AIRPORT PRIVATIZATION**



Appendix C-2 provides a summary of 21 landmark airport privatization transactions reviewed by the research team, including the transaction and governance structure, political and regulatory environment, objectives of the privatization, economic and other regulation, and lessons learned. At all of these airports, there has been a direct transfer of responsibility from the government to the private sector at some stage in their development.

In this appendix, the research team provides an assessment of some of the common features of the 21 landmark airport privatizations with a focus on the lessons learned, and on aspects of these transactions that may be relevant to the U.S. airport industry. Because the context for these

privatization processes differ from that in the U.S., care must be taken in considering the whole context before evaluating the extent to which the lessons are directly transferrable.

One important distinction is the degree to which airports in other countries tend to be seen more as independent entities and businesses in their own right, with a far lower degree of airline control (contractual or statutory). Therefore, external economic regulation tends to have a far greater direct impact on airports in other parts of the world than in the U.S. – where airline rates and charges are largely driven by the terms of airline use and lease agreements. The main focus of economic regulation in other parts of the world by governments and regulators is to seek approaches that provide greater efficiency incentives.

## C.2 Scale of Transaction

Of all the airport privatization transactions reviewed, either the airport is of a relatively material size in terms of passenger throughput, or the entity is a group of airports that includes smaller airports as shown in Table C.1.

**Table C.1. Passenger Throughput (Enplaning and Deplaning)**

<b>Airport/Airport System</b>	<b>2009 Passengers (in millions)</b>
Argentina	19
Athens	16
Auckland	13
BAA	112
BAA (Ferrovial)	112
Berlin	21
Brussels	17
Budapest	8
Copenhagen	22
Costa Rica	3
Delhi	24
Japan Air Terminal	61
London Gatwick	32
Manilla	24
Mexico	47
Naples	5
Rome	40
St. Petersburg	7
Sydney	33
Toronto	30
Vienna	18

The smallest airport in this sample is Costa Rica Airport with 3 million passengers per year. There are certainly examples of airports smaller than this being sold on a standalone basis (in the UK examples include Leeds, Exeter, Cardiff, and Bristol). However, standalone privatizations have been most common with the world’s busiest airports. There are likely to be several reasons for this:

- Privatization involves significant transaction costs, including legal and investment banking advice. For a small airport, those transaction costs are likely to represent a high proportion of the transaction value.

- Many smaller airports are unviable. Although there are several examples of airports with throughput of 1 million passengers per year or even lower that generate positive Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA), they are in the minority. Although it is not impossible, it is relatively problematic to attract investors to loss-making airports.
- Larger airports tend to have lower reliance on single carriers or routes, and therefore to have relatively lower risk profiles, which helps to make them more saleable.
- The lower risk profiles of larger airports also makes the future investment frequently required easier to finance.

The privatization of an airport group is often the result of an attempt to address the concerns of the vendor. Groups of airports in Argentina, Mexico, and BAA generally consist of a handful of highly profitable international airports together with a large number of loss-making small airports fulfilling social needs. A typical public sector arrangement (practiced in Mexico and Argentina) is for the state entity to cross-subsidize the ‘social’ airports from the profits made by the international airports. Under privatization, a common practice is to privatize the ‘social’ airports together with the profitable airports, to avoid the funding of the former falling to the government. In such privatizations, a condition of sale is typically to require the continued operation of such ‘social’ airports.

### **C.3 Types of Privatization Models**

There are two main aspects to the type of privatization model: the approach to selling the shares and the model of ownership. The Table C.2 summarizes the approach and model applied for the airport transactions reviewed.

**Table C.2. Privatization Model**

<b>Airport/Airport System</b>	<b>Date</b>	<b>Method of Sale</b>	<b>Type of Privatization</b>
Argentina	1998	Trade sale	Concession
Athens	1995	Trade sale	Concession
Auckland	1998	IPO	Freehold
BAA	1987	IPO	Freehold
BAA (Ferrovial)	2006	Public tender offer	Freehold
Berlin	2003	Trade sale	Concession
Brussels	2004	Trade sale	Freehold
Budapest	2005	Trade sale	Concession
Copenhagen	2005	Public tender offer	Freehold
Costa Rica	2001	Trade sale	Concession
Delhi	2005	Trade sale	Concession
Japan Air Terminal	2007	On market purchase	Freehold
London Gatwick	2009	Trade sale	Freehold
Manilla	1999	Trade sale	Concession
Mexico	1998-2006	Trade sale (subsequent IPO)	Concession
Naples	1997	Trade sale	Concession
Rome	1997-2007	Trade sale (previous IPO)	Concession
St. Petersburg	2009	Trade sale	Concession
Sydney	2002	Trade sale	Concession
Toronto	1993	Trade sale	Lease
Vienna	1992-2001	IPO	Freehold

There are several conclusions to be drawn from this analysis. First, there is a strong preference for a trade sale of a concession over other models. This is a preference that has become increasingly clear over time and despite the fact that several earlier privatizations adopted the BAA model, i.e. IPO of a freehold sale.

There are several reasons why a combination of trade sale and concession has become the predominant model. Trade sales are primarily attractive because of the higher receipts they yield to the seller compared with IPOs. There are a number of reasons for this:

- The trade buyer is typically an experienced purchaser, and has often gone through significant expert due diligence of the asset in a way that is not open to IPO purchasers. The risks attached to the purchase are therefore lower.
- Trade buyers can develop and implement a strategy for the company in which they are confident, and if necessary hire the required staff to implement it. Retail buyers are dependent on the company's management to develop and realize such strategies, and their confidence in the competence of the management team will impact the price they are willing to pay.
- Trade buyers have been able to apply modern financing techniques to fund their purchase, which has enhanced value.

The auction process frequently associated with trade sales means that the highest value can be secured. IPOs are priced in the absence of such clear value signals and concerns over the issue failing (leaving doubt on future sales), which means that pricing tends to be cautious with a degree



of a post-sale price rise seen as a good thing. This is particularly the case with sales involving the retail market.

There are other advantages of trade sales:

- A trade sale creates the opportunity of securing an expert buyer who may be capable of improving the operations, efficiency, and service standards of the airport concerned. Many sellers insist on an appropriate airport operator being part of the purchasing team.
- A trade sale can be based on a business and investment plan for the airport that has been scrutinized by the seller and may be the source of new impetus for the airport's progress.
- A trade sale reduces the political risk for the seller since it is protected from:
  - Accusations of selling at too low a price if the share prices arising from the IPO climb sharply.
  - Pressures to rescue purchasers if the company fails. In an IPO scenario, there will always be cases of 'widows and orphans' who have invested their 'life savings' if things go wrong.

The use of a concession has been seen as a way for governments to reassert control over assets either in the last resort or at the end of the concession lifetime. Among the benefits are:

- From the standpoint of public perception, ownership of a strategic national asset is retained. This can be a sensitive issue, particularly if foreign buyers are involved.
- The concession documentation can be a way for the sellers to maintain control over areas which it believes to be strategic. These can include, for example, investment programs, service standards, and pricing policies. Concession agreements can in some cases extend hundreds of pages.
- Concessions offer the opportunity for the seller to participate in the continuing success of the airport through rents or performance related concession payments, which may, for example be related to turnover, profit, or traffic levels. This can have strong advantages for airports which are seen as high risk or facing major initial capital expenditure requirements.

Two other trends emerge from this:

- The absence of transactions based on property type leases (such as used by U.S. airlines in leasing capacity at airports). It is likely that the concession can be drawn in a more flexible and all embracing way than the property lease.
- The linkage of trade sales and concession. Whereas most IPOs are of freehold sales, trade sales have frequently been conducted of concessions. Private companies are comfortable in managing investments with a limited lifespan and with the possibility of attempting to secure renewal. It would be likely that there would be significant issues with listing an asset with a limited lifespan, particularly in the case of retail buyers who will be aware that they lack detailed understanding of the concession and renewal process.

## C.4 Transactional and Governance Structure

While the initial privatization of BAA was based in a belief in a ‘hands-off’ model with as much responsibility for the future of the company being transferred to the private sector as possible under regulation, such a laissez faire approach has now become relatively rare. Instead governments have structured sales in ways that allow them to retain a degree of continuing involvement.

The previous section outlined the continuing trend towards concession/lease rather than freehold sale arrangements. Other areas that have been important concerns in a number of privatizations have been:

- The maintenance of a continuing shareholding
- Controls on the identity of the new owners
- Competition issues
- Specific development plans

### *Maintaining a Continuing Shareholding*

Airports have always been regarded as high-profile and sensitive assets conferring both economic benefits and environmental penalties on the communities they serve. As a result, national and local governments have felt pressures to retain at least some stake in the privatized airports, and in practice some form of continuing presence is very common – particularly in countries which see themselves as outside the ‘Anglo-Saxon’ business model.

While majority government ownership would appear to have a major effect on a company’s objectives and management styles, the presence of even significant minority stakes appears to have a much lower impact. The experience of majority private sector shareholders in the airports shown in Table C.3 below is that their Government partners generally appear to adopt a policy of self-restraint in their interventions as shareholders and that following a move to majority private sector ownership tend to be content to limit their roles largely to monitoring and occasionally advising. As a result, even highly pro-active airport owners such as Macquarie appear to be content to work with significant and continuing minority government shareholdings at Copenhagen and Brussels as illustrated on Table C.3.

**Table C.3. Government Holding Shares**

Airport	2009 Government Holding
Athens	55.0%
Auckland	22.4%
Brussels	25.0%
Budapest	25.0%
Copenhagen	39.2%
Delhi	26.0%
Naples	25.0%
Rome	4.1%
Vienna	40.0%

This does not mean that the government presence has not been valuable, but it appears that the

main contribution has been in maintaining public confidence and ensuring good corporate practice, rather than necessarily in making the leading contribution to the airport's strategy. This suggests that the decision to retain only a minority shareholding is associated with the acceptance that the private sector will (and possibly should) take the lead.

On a less positive note, the relatively restricted role for government as part-owners of an asset might be expected to be associated with more limited support for its interests in the airport asset. For example, governments may have more concern for the health of ailing flag airlines and environmental issues than for the value of their airport holdings.

### ***Controls on the Identity of the New Shareholders***

Under normal circumstances, once a company has been sold, the previous owners have no say in the further sales which take place. In the case of the privatization of a strategic asset, this may raise concerns and governments may seek to have controls which enable them to restrict:

- The maximum stake to be held by an individual owner
- The maximum stake that can be held by overseas interests
- The maximum stake that can be held by an owner with a cross-ownership in shares in a competing airport
- The disposal of shares by specific shareholders (particularly in a trade sale where a major airport operator was sought as a strategic partner to aid the development of the airport)

Such controls are relatively easy to apply in the case of concessions where the concession contract can be with specified buyers, and government permission must be sought before the contract can be transferred.

Governments have also attempted to apply controls to trade sales, either through primary legislation or through sales contracts.

An approach that was applied to both the BAA and the Copenhagen airport IPOs was the use of a 'golden share' which had no economic value but could effectively veto decisions in specific areas, including asset disposals and maximum share ownerships. Such 'golden shares' were outlawed within the EU as a national restraint to trade, leaving both BAA and Copenhagen subject to takeover by Spanish and Australian interests, respectively.

In some countries, such controls can be applied less formally. Following Macquarie Airport's acquisition of a major stake in Japan Air Terminal (JAT), the Japanese Government made its displeasure clear, both publicly and privately, and indicated that it would not permit a stake in JAT greater than 20% of the total. Macquarie subsequently disposed of its shareholding through a buy back orchestrated by JAT.

### ***Competition Issues***

The sale of one or more airports can provide an opportunity to consider what competitive structure would be desirable, particularly if the airports concerned are members of a group with a dominant position either locally or nationally.

In the case of BAA's privatization, the UK Government was criticized for not breaking up the group's dominance of airports in the South East of England and in Southern Scotland. While some other privatizations, such as that of Argentina, have adopted a similar national approach, others used the privatization process either to sell off airports individually (Australia) or as rival groups (Mexico).

On the other hand, there have been cases where the potential opening of a competing airport has been seen as a threat to the private sector's willingness to make major airport investments. Both Athens and Delhi airports, for example, have provisions preventing the opening of a significant new airport within a defined distance from the airport being developed. In other cases – such as Sydney – the airport buyer has been given a 'right of first refusal' on any major new airport development in the Sydney region.

### ***Specific Development Plans***

One of the principal reasons for an airport privatization may be to allow major developments to take place, which the government is reluctant or unable to fund. In such cases, the government involved will clearly wish to ensure that the required developments actually take place. Once again this can be achieved through a concession agreement (as in Athens or Delhi) or –with less assurance – through regulation.

The government may also incorporate other mechanisms in the privatization process. For example they may:

- Include the production of a development plan as part of the sales process
- Require the development, publication, and regular revision of a master plan to be approved by the Government (as in Australia)
- Include a general requirement to develop the airport to meet needs at given service standards (and possibly more specific requirements) within the terms of a license to be held by the airport operator (as for example in Brussels)

## **C.5 Objectives of Privatization**

The objectives of the earliest privatization – the BAA privatization in 1987 – can be seen in hindsight as primarily ideological (source: the Airport White Paper):

*The Government is committed to converting as many as possible of Britain's airports into private sector companies as part of its policy of reducing the role of the State. The Government is confident that the privatization of airports will bring substantial benefits. Besides reducing the size of the public sector, privatization will assist the Government's objective of creating wider share ownership. It will also increase employee participation as, in line with previous privatizations, employees will be encouraged to buy shares at*

*the time of sale. Privatization will also provide for greater freedom for management. For example, airports will have access to private capital. It will also encourage more innovative management, and lead to efficiency gains and greater responsiveness to customers. These benefits will have profound consequences for the future operation of airports in Britain<sup>1</sup>*

Implicit in these objectives is a belief in the private sector offering superior management, efficiency gains, and responsiveness to customers. An IPO was seen as offering these potential gains even though the actual management personnel and the structure of the organization remained unchanged. These objectives were set in addition to a stated belief in the importance of reducing the role of the public sector.

In sharp contrast, the objectives quoted for the most recent transaction in the airports surveyed (the 2009 privatization of St. Petersburg) are twofold. This privatization was developed by the City of St. Petersburg to (1) seek funds for upgrading infrastructure and (2) attract the services of an experienced airport operator to enhance the operations and service at the Airport. It is noteworthy that ‘seeking funds’ is not included in the BAA objectives, although directly or indirectly such an objective is behind many recent airport privatizations.

It is likely that the downplaying of the more ideological justifications for airport privatization has resulted from several factors. As the transaction summaries illustrate in the cases of Argentina, Manila, and Toronto, privatization is not by itself a guarantee for improved operation or greater customer focus. As discussed above, the experience of the IPO / freehold model where management, financial, and operational structure were left fundamentally unchanged is that potential benefits were left unrealized. In the case of BAA, this led ultimately to an enforced split up of the group some 22 years later and in the case of Copenhagen, to a secondary trade sale to buyers believing that further performance gains could be secured.

Furthermore, in recent transactions such as St. Petersburg and Delhi, the structure of the arrangement based on fixed capital investment programs effectively implies a coalescing of airport privatization with pre-privatization models for private sector involvement such as Build Operate Transfer.

In sum, there has been a narrowing of objectives of privatization to a focus on the fund-raising properties of airport sales.

## **C.6 Economic Regulatory Regimes**

Privatization is frequently associated with the introduction of, or major reform to, formal economic regulation that applies to the private company.

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<sup>1</sup> Cm 9542, 1985 *White Paper*, Airports Policy, June 1985.

The most obvious form of regulation is price controls. Table C.4 provides an indication of the types of price control models employed under the surveyed transactions:

**Table C.4. Regulatory Model**

<b>Airport/Airport System</b>	<b>Regulatory Model</b>
Argentina	CPI-X, cost basis unclear
Athens	Accumulative profit control over long period, dual till
Auckland	Reserve powers regulation, dual till
BAA	CPI-X, single till
BAA (Ferrovial)	CPI-X, single till
Berlin	Price approval
Brussels	CPI-X, dual till, reserve powers
Budapest	CPI-X, dual till
Copenhagen	CPI-X, dual till, reserve powers
Costa Rica	CPI-X, dual till, not transparent
Delhi	CPI-X, hybrid till
JAT	Price approval
London Gatwick	CPI-X, single till
Manilla	Unclear
Mexico	CPI-X, dual till
Naples	CPI-X, hybrid till
Rome	CPI-X, hybrid till
St. Petersburg	Annual approval, unclear
Sydney	Reserve powers regulation, dual till
Toronto	Lease payments
Vienna	CPI-X, not transparent

The first major variable is the extent to which price controls are directly applied by an external regulator in the form of ‘heavy-handed’ price control. While this was the form adopted in BAA’s regulation, it has not been universal since.

A number of countries such as Denmark, Belgium, Australia, and New Zealand employ various forms of ‘light-handed regulation’ where price controls are negotiated between airports and airlines, with – in some countries – reserve powers for the state or a regulator to intervene in the event of non-agreement. Experience in those countries is that despite difficult discussions, agreement is generally reached, normally founded on a shadow or informal process that parallels the formal regulatory process.

Of interest, as noted earlier in the context of London City Airport, despite the heavy-handed regulation applied to major airports in the UK, most privatized UK airports are not price-controlled: instead reliance is placed on commercial negotiations and competition. The apparent effectiveness of this competition at regional airports has led the UK to move Manchester Airport out of price controls, and to consider a similar exemption for Stansted Airport. Price controls now only apply to Heathrow, Gatwick, and Stansted, each with more than 20 million passengers, and it has been suggested that in the long run they might be limited to Heathrow.

The second variable is the form of price controls. In many cases some form of multi-year direct price control has been applied, generally related to inflation through a CPI-X formula. Such formulas are increasingly derived from a forecast of future costs and capital expenditures using what is known as a ‘building blocks’ methodology, although it is possible to set X through other methods (including direct estimates of the scope for improving efficiency). CPI-X price controls provide more incentives to the private operator than profit controls. Under CPI-X controls, the private operator receives the benefits of maximizing efficiency without having to share the benefits with customers in the form of a lower cost base at the next review.

An alternative approach, used in Germany and Russia, is to rely on the private operator to submit proposals for any change in prices to a regulator, who may approve, disapprove, or amend the proposal based on criteria, which are frequently not transparent. While this may be a familiar (and possibly manageable) process to the parties concerned, it may raise concerns from potential investors over the lack of stability and predictability in price setting. This is particularly an issue where major investment is being contemplated that may require substantial price rises if it is to be remunerated, or – less positively – where a major airline is facing difficulties.

At Athens, where the principal concern was with funding a major green-field airport, a form of profit control has been applied, with the concession providing controls that cover the accumulative rate of return up to the time of the price setting concerned. This provides significant comfort to investors, while allowing the private operator to set prices below the potential maximum in initial years, with the intention of recovering the lost income at a later date.

Another concern is with the use of single till or dual till approaches. Single till prices are set by setting allowable aeronautical revenue equal to all costs (including return on capital employed) minus commercial revenue. Under dual till, allowable aeronautical charges revenue is set to cover only aeronautical costs without consideration of non-aeronautical income and costs. The single till approach is broadly equivalent to residual rate-setting methods in the U.S. while dual till is seen as equivalent to compensatory rate-setting approaches.

Single till is generally preferred by airlines (supported by IATA), which see it as leading to lower charges, while dual till is seen as having greater incentives for efficiency and as facilitating investment. In practice, the case on charges is not clear since the efficiency incentives may outweigh the opportunities for a commercial subsidy. Evidence from comparisons of actual charges set is ambiguous. On the other hand, despite the supposed advantages in dual till airports in promoting investments, some single till airports – notably Heathrow – have been capable of very major capital expenditure.

In the U.S., residual approaches are seen as providing a greater degree of risk to airlines, since the airlines are contracted to cover pay charges recovering the required income to meet costs on an annual basis, and under residual approaches they face risks of annual volatility arising from passengers, costs, and commercial income. This is less apparent at privatized airports outside the U.S. where very long term contracts are rare (and not generally seen as binding on airlines) and prices tend to be set either through formulae over several years, or by an approval process which is less defined and mechanistic, or effectively to be set by market pressures. Each of these has the effect of leaving more of the risk (and benefit) in individual years with the airport. To the extent that the privatization process moves price setting approaches closer to those of international airports

(for example by fixing the price for a number of years as was proposed at Midway) the relative merits of the two methodologies are closer to those experienced elsewhere.

One point that does appear clear is that in most cases dual till controls are more attractive to investors since they do not put an implicit cap on overall profitability. As a result, a move to dual till – either at once or over time (as in Brussels or Aeroport de Paris), may be seen by government as a way of increasing privatization returns.

In addition to prices, economic regulation is also concerned with service, and with ensuring that investment efficiently meets the needs of current and future users.

- Reducing *service* can be regarded as having the equivalent effect on profits to a hidden price rise. As a result, the inclusion of service metrics is increasingly being linked to price controls, with penalties for failure to achieve service targets, and (more rarely) bonuses for exceptionally good performance;
- Cost-related price formulas are generally based on a *capital program* (which may have been directly agreed with users as at Heathrow). Investing below this level without good reason (such as a change in user needs or technology) can also have an effect equivalent to a price rise, although it should also be noted that poorly constructed regulation can also lead to perverse incentives to ‘gold plate’ individual projects. In response to this, the delivery of a capital plan can be related to charges by:
  - Directly agreeing to price increases linked to individual investments once plans have been finalized (as in the Australian Necessary New Investment approach)
  - Including ‘trigger’ provisions in the price formula from the outset, linked to the completion of specific investments (as in the UK)
  - Directly relating charges to overall investment levels

It is also possible to have a retrospective ‘claw back’ mechanism which refunds the costs imposed on airlines for under spending on a capital program. However, this is normally not regarded as good regulatory practice because it fails to encourage efficient capital expenditure and penalizes users with charges higher than they need to be.

## C.7 Conclusions

Because privatizations are undertaken for a variety of reasons, it is difficult to comment generally on their success, although second and third generation airport privatizations have the benefit of reviewing past experiences to better structure the process (e.g., the inclusion of service metrics). The review of transaction summaries allows one to draw a number of high-level conclusions, but each individual privatization or privatization attempt is associated with its own lessons learned. For this reason, the transaction summaries contained in Appendix C-2 each contain a lessons learned section specifically written for that privatization.

At a higher level, the following observations are worth noting:



- Generally, privatizations have involved larger airports or groups that contain both large and small airports. For a number of reasons, such privatizations are more likely to be attractive to potential investors.
- Internationally, there has been a trend towards trade sales to experienced buyers (rather than IPOs) and towards concession agreements (rather than freehold sales). Such privatizations have a number of benefits, but particularly enable the respective governments to raise higher proceeds while at the same time retaining an element of control or ownership over what is seen as an important piece of national infrastructure. Clearly under majority sale of a freehold, direct ownership and control will have been lost.
- Even minority stakes held by private investors can provide many of the efficiency and innovative business practices benefits of involving experienced private operators.
- Concessions may have the additional advantage of enabling the seller to participate in the continuing success of the airport through securing returns from rental payments or performance related payments. This may have particular advantages for some sorts of privatizations where buyers would be unwilling or unable to make high upfront payments.
- In addition to the concession agreement, governments have developed a number of ways to influence the behavior of the new airport owner. These include retaining an ongoing shareholding and including certain investment or service level specifications in the transaction documentation.
- Privatizations have occurred for a variety of reasons, ranging from financial (raising upfront or ongoing proceeds) to idealistic (belief in the benefits of private sector management).
- Economic regulation is an important tool to curb the monopoly pricing power which some airports have. A number of approaches have been pursued, but price cap regulation is increasingly common.

Subject to the specific observations made above, it is expected that some of these lessons would be potentially relevant to full airport privatization in the U.S. with appropriate modifications. However, the much lesser role for formal price regulation at U.S. airports, means that any move to price cap controls is likely to be secured in the U.S. through agreed upon modifications to the airlines' contracts rather than through decisions made by an external regulator, except under the APPP where increases to airline rates may not exceed inflation without the consent of 65% of the airlines.

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## Appendix C.1

### Glossary of Privatization Terms

<b>Term</b>	<b>Definition</b>
<b>Build Operate Transfer (BOT)</b>	An approach to development of airport infrastructure where the entity constructing it operates it over a period of time before transferring it (usually back to the public sector owner)
<b>Building blocks</b>	Within a CPI-X approach to regulation, a methodology where costs are defined as operating costs, and return of and on capital
<b>Claw back</b>	A feature of regulation where excess profits made in one regulatory period are recovered by the regulator in the subsequent period
<b>Concession</b>	Contract to transfer rights to manage and or operate a property for a certain period, usually without property rights
<b>Corporatization</b>	The process by which an airport previously subsumed within a Government agency is embodied with legal and financial person
<b>CPI-X</b>	A regulatory regime in which aeronautical prices increase by inflation (the consumer price index) less a specified percentage (X)
<b>Dual till</b>	An approach to regulation of aeronautical charges where the level of charges is set to recover aeronautical costs only
<b>EBITDA multiple</b>	The implied enterprise value divided by the airport's EBITDA (earnings before interest, tax, and depreciation). It should be noted that in some cases this multiple is specified publicly for a sale even though the assumptions on EBITDA and Enterprise Value are not themselves directly stated
<b>Freehold sale</b>	An estate in land, a form of fee simple ownership
<b>Gold plating</b>	A perceived problem of systems of economic regulation that incentivize over-investment
<b>Golden share</b>	A share held usually by Government without economic value which conveys defined voting rights over airport strategic and other decisions
<b>Heavy handed regulation</b>	An approach to regulation of aeronautical charges where price approval is set with maximum regulatory intervention
<b>Hybrid till</b>	An approach to regulation of aeronautical charges where the level of charges is set to recover aeronautical costs less a subsidy from the profits of non aeronautical activities

<b>Term</b>	<b>Definition</b>
<b>Implied enterprise value</b>	The total value of an airport asset implied by a particular transaction value. This is generally obtained by up-rating the transaction value to the equivalent of a 100% sale and adding the value of debt. The up-rating process for the equity may be complicated in cases where the proportion of shares owned does not reflect the economic value (for example where there are different classes of shares with different voting powers or rankings in terms of dividend distribution)
<b>Initial public offerings (IPO)</b>	Sale of shares (stock) in a company on its first public listing
<b>Lease</b>	Contract by which airport is conveyed to an entity for a specified period
<b>Light handed regulation</b>	An approach to regulation of aeronautical charges where price approval is set with minimal regulatory intervention, potentially through reserve powers regulation
<b>mppa</b>	Million passengers (departing + arriving) per annum
<b>On market purchase</b>	Purchase of shares/stocks on public stock exchanges
<b>Price approval</b>	Approval of aeronautical charges by the relevant entity
<b>Public tender offer</b>	An offer to qualified entities to bid for ownership of an airport
<b>Regulatory Asset Base (RAB)</b>	The investment base upon which the operator is permitted to earn a reason return.
<b>Reserve powers regulation</b>	An approach to regulation of aeronautical charges where price approval is set by agreement between airports and airlines, with an independent regulator deployed if agreement is not reached
<b>RPI-X</b>	A regulatory regime in which aeronautical prices increase by inflation (the retail price index) less a specified percentage (X)
<b>Secondary sale</b>	Sale of an airport to a party by the party making the initial purchase
<b>Single till</b>	An approach to regulation of aeronautical charges where the level of charges is set to recover all costs (aeronautical and non aeronautical)
<b>Trade sale</b>	Sale of an airport to a trade buyer (i.e., an existing commercial entity)
<b>Transaction value</b>	The \$ amount transferred between parties in consideration of transfer of an airport asset, or part thereof
<b>Widows and orphans</b>	Small, usually private share (stock) holders

## **Appendix C.2**

### **Worldwide Airport Privatization Transaction Summaries**

## Argentina Airport System

### a) Transaction Summary

Item	Description
Airport	Argentina Airport System
Operational details	<p>System of 33 airports, including the airports serving Buenos Aires.</p> <p><b>2009 passengers:</b> 14 million at the two main airports serving Buenos Aires. (In 1997, there were 18.8 million passengers serving the 33 airports).</p> <p><b>Principal airlines:</b> Aerolíneas Argentinas</p> <p><b>Configuration:</b> Ezeiza-Ministro Pistarini International, serving Buenos Aires, has two runways. Jorge Newbery, also serving Buenos Aires, has one.</p>
Type of privatization transaction	Trade sale. Concession.
Interest	100%.
Date of transaction	February 1998.
Valuation	<p><b>Transaction value:</b> US\$2.2 billion investment commitment plus annual license fee of US\$ 171 million.</p> <p><b>Implied Enterprise Value:</b> n.a.</p> <p><b>EBITDA multiple:</b> n.a.</p>
Context	<ul style="list-style-type: none"> <li>• Large country with network of domestic airports providing links to the capital Buenos Aires.</li> <li>• Chronic underinvestment prior to privatization.</li> </ul>

### b) Transactional and Governance Structure

Decree 375/97, which came into effect in Argentina in 1997, provided for the establishment of a group of airports, the management and operation of which would be offered to a private operator through a concession agreement. The Government bundled the 33 airports into a single concession because it estimated that only up to 8 airports were profitable thereby necessitating the need for cross-subsidies to improve facilities at many airports. The Argentine Government ran a bidding process and received four bids for the concession. The winning consortium was Aeropuertos Argentina 2000 S.A. (AA2000), created specifically for the purpose of acquiring and operating this group of airports in Argentina.



Initially, AA2000 had five shareholders: Corporación América Sudamericana S.A. (“CAS”); Ogden Corporation (“Ogden”); Società Esercizi Aeroportuali, s.p.a. (“SEA”); SIMEST (“SIMEST”); and Riva Construcciones S.A. (“Riva”) (the “Shareholders”).

**AA2000 Shareholders**

Shareholder	Share	Description
CAS	35%	An affiliate of a Buenos Aires-based conglomerate with business mainly in media
Ogden	28%	NYSE listed company engaged in aviation-related, energy, and entertainment services worldwide
SEA	28%	Operator of the two airports serving Milan, Italy (Malpensa and Linate airports) and provider of airport consulting services globally
SIMEST	8%	State-owned development bank located in Rome, Italy
Riva	1%	Argentine-based, turn-key construction company serving industrial and institutional clients

Ogden Corporation later sold its share to CAS in the course of divesting itself of all of its aviation companies.

The agreement between AA2000 and the Argentine Government was formally entered into on February 9, 1998, and has a term of 30 years. The Argentine Government has the option of extending the agreement for an additional 10 years, under certain circumstances. Under the agreement, AA2000 assumed development, improvement and operation responsibilities for the 33 “Group A” airports in Argentina. These airports comprise over 60% of the airports in Argentina, and include airports in Buenos Aires (Jorge Newbery and Ezeiza-Ministro Pistarini International), Cordoba, Mendoza and Bariloche. Additionally, 17 of these airports are equipped to receive international flights. Taken together, the “Group A” airports served approximately 96% of total passengers in Argentina in 2007.

The concession was based on a build-operate-transfer (BOT) arrangement with an investment commitment of US\$2.2 billion (in 1998 dollars) over the concession period and a \$171.2 million per year royalty (canon) fee to the Government. The terms of the concession required AA2000 to submit a master plan for each concession airport. The master plan details the amount and timing of the investment required for each facility. Most of the \$2.2 billion in investments were slated for Ezeiza (the Buenos Aires international airport), Bariloche, and Cordoba Airports. AA2000 also committed to close Aeroparque Jorge Newberry (the Buenos Aires downtown airport) and to consolidate its operations at Ezeiza.

The concession contract provides AA2000 with certain rights and obligations under the terms of the concession, including the right to collect specific aeronautical fees levied upon users of the concession airports. Aeronautical charges, which are regulated by the Government, consist of aircraft landing, aircraft parking, passenger departure, and jetway usage charges. In addition, AA2000 has the exclusive right to operate and exploit commercial activities within the perimeter of each concession airport. These activities are unregulated under the concession contract and AA2000 has the right to negotiate the terms of commercial arrangements. AA2000 is also responsible for employment and supervision of airport personnel and contractors.

In 2007, AA2000 entered into a Memorandum of Understanding (MOU) with the Argentine Government, which amended the original concession agreement. The terms of the MOU led to a revision in the structure of the payments of concession fees to the government. Changes introduced

under the MOU were driven primarily by the after-effects of the severe economic contraction experienced in Argentina earlier in the decade.

### **c) Political and Regulatory Environment and Objectives of the Privatization**

During the 1990s, Argentina underwent a period of economic reform, with a large number of public institutions privatized including telecommunications, utilities and transport infrastructure. The privatization of the airports formed part of this larger program. Considering the historic underinvestment in the airports, it is likely that attracting private financing to fund infrastructure development was one of the Government's main objectives.

### **d) Economic and Other Regulation**

Certain key functions remained with the Government under the control of the Argentine Air Force. These duties include air traffic control, national security responsibilities, customs, police, fire, and immigration. Air traffic control is handled by the Regional Air Command and security is overseen by the National Aeronautical Police Force, both divisions of the Air Force. The Government also assumes responsibility for emergency response services in the event of a major aviation accident.

The Government established a new regulatory body, the Organismo Regulador del Sistema Nacional de Aeropuertos (the National Airport System Regulatory Body, or "ORSNA"), to monitor AA2000. ORSNA is responsible for setting aeronautical fee levels, monitoring compliance with the master plan at each airport, and monitoring the quality of services delivered by AA2000. Changes to aeronautical rates (aircraft landing, aircraft parking, airport use, and telescoping jetways) require the approval of ORSNA. The initial rate schedule of aeronautical rates was established prior to the award of the concession and AA2000 may charge rates up to those approved and established by the ORSNA. Approved rates are subject to change every three to five years (if decreed by ORSNA). As set forth in the concession contract, changes to the aeronautical tariffs are to be based on a pricing formula of "PPI-X Factor" where PPI is the producer price index in the United States and the X Factor is a number (expressed as a percentage) that incorporates a number of concession factors (increases in traffic, improvements in efficiency, level of service, projected return on investment, and rate of return). The Government increased aeronautical rates by approximately 35% prior to the privatization and instituted a number of new charges, including the jetway charge. Increases in non-aeronautical charges, including airline terminal space rental, are not subject to the aeronautical pricing adjustment formula.

The Government issued a moratorium on the construction of new airports within the spheres of influence of the concession airports for a minimum of 20 years thereby creating a natural monopoly for domestic and international air traffic for the concession.

### **e) Lessons Learned**

The privatization of Argentina's airports resulted in a number of challenges, particularly in light of the steep downturn in the Argentine economy shortly after the privatization. The original concession agreement, which envisaged a fixed concession fee in US dollars, did not have enough flexibility to cope with these challenges, and a renegotiation was required. IATA was highly critical of the perceived high level of airline charges resulting from the privatization. Key lessons learned include:

- Any concession agreement will only work successfully in securing the development of airports if the investments required remains viable. Care must be taken in the design of concession terms to ensure that the approach is robust to adverse circumstances, or

privatized airports facing such circumstances will find it difficult to make the investments required to meet airline needs;

- The continuing problems associated with overbidding for concessions provide a case for making concession tenders dependent not only on the highest bid, but on the most convincing business plan for delivering the returns required to sustain that bid. In this case, the highest bidder's annual royalty was four times higher than the minimum guarantee in the bid documents and in the event, this level of royalties turned out to be unsustainable – ultimately requiring a renegotiation with the Government. In the meantime, AA2000 had to raise rents and fees for most facilities and services significantly to cover the Government payment, which was not well received by the airlines and other tenants. The production of a credible business plan should have helped to demonstrate to the Government seller whether the buyers were capable of meeting their obligations while also serving the needs of airlines and passengers. There may well be fewer problems with an outright sale though even there over-bidding associated with continuing problems of high leverage may not be in the long term interest of the seller or of airlines;
- Significant increases to airline tariffs may have reduced airline's ability to lower fares to increase throughput and grow the sector, in particular for domestic services; and
- Major construction is likely to entail a significant increase in charges – especially if the charges in place before the privatization were set at non-viable levels. The seller should ensure that the implications of this are understood and evaluated in the sales process, and should consider consulting the airlines in advance on the extent to which the development plans and the associated costs meet their needs.

### **Relevance to Privatizations in a U.S. Context**

Despite the different environment, many of these lessons are relevant to U.S. privatizations. However, the strong roles envisaged for airlines in agreeing privatizations through the Pilot Program, would be likely to mitigate the concerns on the impact on airlines of new investment reflected in the final bullet point.

## Athens Airport

### a) Transaction Summary

Item	Description
Airport	Athens Airport
Operational details	<p><b>2009 passengers:</b> 16 million</p> <p><b>Principal airlines:</b> Aegean Airlines, Olympic Air.</p> <p><b>Configuration:</b> Two runways. One main terminal and one satellite terminal.</p>
Type of privatization transaction	Trade sale. Concession.
Interest	45%.
Date of transaction	July 1995.
Valuation	<p><b>Transaction value:</b> €2.1 billion investment in new airport (approx. US\$2.1 billion).</p> <p><b>Implied Enterprise Value:</b> n.a.</p> <p><b>EBITDA multiple:</b> n.a.</p>
Context	<ul style="list-style-type: none"> <li>• Greece's largest airport.</li> <li>• Privately financed construction of new airport.</li> </ul>

### b) Transactional and Governance Structure

In 1975, the Greek Government decided to build a new airport to serve the greater Athens area. The location of the new airport was determined in 1978, and expropriations and planning works took up a number of years after that, from 1978 until 1991.

In 1991, the designated area was available, and the Greek Government decided to run a tender process under a build-operate-own-transfer scheme, to identify a private partner for the construction of the new airport.

A consortium led by Hochtief was declared the winning party in 1993, but a change of Government in September of that year led to a suspension of the tender procedure and a redesign of the contract. The Hochtief consortium was again declared to be the winning party in 1994.

In July 1995, the consortium signed an Airport Development Agreement with the Greek Government. This agreement was subsequently ratified by the Greek Parliament through law 2338. The agreement establishes a 30-year concession granting the airport company the exclusive right to occupy and use the site for the purpose of the design, financing, construction, completion, commissioning, maintenance, operation, management, and development of the airport. No upfront payment was required. Annual concession payments were as follows:-

- First ten years nominal (€1000)
- Second ten years - €1m
- Third ten years - the greater of €15m or 15% of operating profits

In June 1996, a new company called Athens International Airport was established. Its shareholders were the Greek Government (55%) and the consortium led by Hochtief (45%) advised by Fraport. Construction of the new airport started in September of 1996. Construction was completed in 2000 and the airport officially opened in March 2001. The project costs of €2.1bn were funded through a mixture of equity, shareholder loans, EU grants, European Investment Bank loans, commercial

loans, and proceeds from an Airport Development Fund charge on passengers at the existing Greek airports.

### **c) Political and Regulatory Environment and Objectives of the Privatization**

The main objective of the Greek Government at the time of the privatization was to attract private funding for the construction of a new airport in the Athens area. The fact that the winning consortium included a major contractor able to provide all engineering and project management services may have been an important factor for the Greek Government.

The Greek Government is currently considering an IPO of some of its remaining shareholdings to raise additional funds to reduce Government debt.

### **d) Economic and Other Regulation**

Airport charges at Athens Airport increased significantly when the new airport opened in 2001. The charges are set on the basis of consultation between the airport, the Charges Committee of IATA and the Board of Airline Representatives.

There is, however, a backstop regulatory framework incorporated into the concession contract. This framework is based on a dual till approach, and allows a compounded cumulative return on 'air activities capital' of maximum 15% real per annum. This provides a mechanism for the airport to agree on credible charges with users at an initial stage with the opportunity to recoup the income foregone further along the line when utilization is higher and unit costs have decreased.

### **e) Lessons Learned**

The Athens Airport privatization is generally seen as successful as the new airport was constructed in a record time and within budget. There was a significant increase in airport charges subsequent to the privatization, but these were linked to very substantial improvements in facilities and services at the new airport: the previous Athens Airport under public ownership had been notorious for its low service standards. Key lessons learned include:

- The move to the private sector can be associated with substantial enhancements in service in the right contractual and regulatory environment;
- Major construction is likely to entail a significant increase in charges – especially if the charges were previously set at non-viable levels. The seller should ensure that the implications of this are understood and evaluated in the sales process, and that, ideally the regulatory approach has sufficient flexibility to allow for losses made in the start-up phase of the project to be recouped later when traffic flows are mature (Athens is a good example of how this can work);
- Airlines will accept even substantial increases in charges provided that the need for improved/new facilities is fully understood and supported; and
- Flexibility in regulation can allow the airport and airlines to reach commercial agreements which both can accept without direct regulator intervention.

### **Relevance to Privatizations in a U.S. Context**

This privatization was made in the context of funding a major new Greenfield development through a private public partnership – with significantly different requirements from those of most US privatizations. Nevertheless, most of these lessons appear potentially relevant to US airports, with the exception of the last bullet point: in the US the greater involvement of the airlines both in

privatization and in the process of setting prices (through their contractual agreements with airports) means that there is a relatively limited role for direct regulation in the price setting process.

## Auckland Airport

### a) Transaction Summary

Item	Description
Airport	Auckland Airport
Operational details	<p><b>2009 passengers:</b> 13 million.</p> <p><b>Principal airlines:</b> Air New Zealand.</p> <p><b>Configuration:</b> One runway (plus one stand-by runway usually used as taxiway). Two terminals: international and domestic.</p>
Type of privatization transaction	Initial public offering. Freehold sale.
Interest	51.6%.
Date of transaction	July 1998
Valuation	<p><b>Transaction value:</b> NZ\$390 million for 51.6% interest (approx. US\$203 million).</p> <p><b>Implied Enterprise Value:</b> n.a.</p> <p><b>EBITDA multiple:</b> 13.1x.</p>
Context	<ul style="list-style-type: none"> <li>• New Zealand's largest airport.</li> <li>• Corporatized in 1988.</li> <li>• One of two airport privatizations in 1998.</li> <li>• The other privatization was Wellington, via a trade sale.</li> </ul>

### b) Transactional and Governance Structure

The most important phase of the privatization of Auckland Airport, the sale of a 51.6% stake by the Government, took place by means of a public flotation in July 1998. The process was a standard IPO process which took just over two months to complete: from announcement on 14 May 1998 to listing on 28 July 1998.

Subsequently, local governments have decreased their minority interests in the airport. The largest shareholder today is Auckland City Council with a 12.7% interest.

### c) Political and Regulatory Environment and Objectives of the Privatization

Before it decided to publicly list a 51.6% interest in Auckland Airport, the Government conducted a scoping study that examined sale options ranging from trade sales to share floats. The criteria against which the sale options were assessed are not publicly known, however, it is known that the scoping study included preliminary sales work. This suggests that the level of proceeds was at least one of the criteria considered by the Government at the time of the privatization.

### d) Economic and Other Regulation

Auckland Airport and Wellington Airport were both privatized in 1998. There was no regulation of airport charges in New Zealand at the time, and no regulation has been put in place since these privatizations, other than requirements for the provision of financial and other information by the airports to users. Reviews of prices can be undertaken by the relevant Minister at any time, and the threat of the subsequent introduction of formal regulation is deemed to be sufficient to ensure prices remain reasonable. A review of prices at major New Zealand Airports was undertaken in 2002, with the recommendation that price regulation be introduced at Auckland Airport. This recommendation was rejected by the Minister as unnecessary in 2003.

Effectively the airport operates under a form of ‘shadow regulation’. The airports have agreed formulas with users typically for five-year periods, based on standard regulatory ‘building blocks’ calculations of costs combined with benchmarking (including the use of Jacobs Consultancy publications) to demonstrate to users that charges are not excessive.

Regulatory changes in 2010 mean that going forward, there has to be greater disclosure of information and specification of a charging methodology and this has to be monitored by the Commerce Commission. These changes are intended to make the negotiation process more effective: there is no indication of any intention of introducing formal price controls.

#### **e) Lessons Learned**

The IPO of Auckland Airport was completed successfully, but there has been subsequent dissatisfaction from airlines as to the lack of regulation of charges at the airport, which the New Zealand Government has met by requirements for greater information provision and monitoring. In particular, new regulatory changes in 2010, due to come into effect in 2011, will place increased transparency obligations on the airport. In contrast a recommendation to introduce formal price regulation was rejected by the Minister in 2003. The key lessons learned was that post privatization regulation need not necessarily require formal price controls. Information provision and monitoring, backed up by the threat of price controls if required, may be sufficient to put downward pressure on prices.

#### **Relevance to Privatizations in a U.S. Context**

The lesson with this transaction concerns a specific approach to external oversight of prices, which is less relevant to privatization in the U.S. where the role for formal external regulation is more limited.



## BAA (IPO)

### a) Transaction Summary

Item	Description
Airport	BAA, including in 1987 Heathrow, Gatwick, Stansted, Glasgow, Edinburgh, Aberdeen and Prestwick airports
Operational details	<p><b>2009 passengers:</b> 112 million (BAA total global passengers, excluding Gatwick which has now been sold).</p> <p><b>Principal airlines:</b> British Airways, BMI, easyJet, Ryanair.</p> <p><b>Configuration:</b>  <b>Heathrow:</b> Two runways, five terminals.  <b>Gatwick:</b> One runway, two terminals.  <b>Stansted:</b> One runway, one terminal (three satellites).  <b>Glasgow:</b> One runway, one terminal (three piers).  <b>Edinburgh:</b> One main runway, one terminal.  <b>Aberdeen:</b> One runway, one main passenger terminal, three helicopter terminals.  <b>Prestwick:</b> One runway, one terminal</p>
Type of privatization transaction	Initial public offering. Freehold sale.
Interest	100%
Date of transaction	July 1987
Valuation	<p><b>Transaction value:</b> £1.2 billion (approx. US\$805 million).</p> <p><b>Implied Enterprise Value:</b> n.a.</p> <p><b>EBITDA multiple:</b> n.a.</p>
Context	<ul style="list-style-type: none"> <li>• UK's biggest airport group.</li> <li>• Between 1965 and 1986, operated as a publicly owned corporation.</li> <li>• Operated with many of the attributes of a private entity.</li> <li>• Net contributor to the public exchequer.</li> <li>• Intention to privatize announced in the 1985 Airports Policy White Paper.</li> </ul>

### b) Transactional and Governance Structure

The intention to privatize BAA was stated in 1985. At the time, there had been no precedents for the private ownership of major airports and some skepticism over whether it would prove practicable or attractive to investors. Nevertheless, the Airports Act of 1986 provided for the dissolution of the Authority (BAA) and the transfer of its property, rights, and liabilities to a new company. On the 1<sup>st</sup> August 1986, the Authority was transferred to a new entity, BAA plc, wholly owned by the Secretary of State. A marketing prospectus was issued in spring 1987. Share dealings in the new company commenced on the London stock exchange on 28<sup>th</sup> July 1987.

The Government offered 50% of BAA at a fixed price with 25% placed with institutions and 25% through a tender offer. It was anticipated that the tender portion of the offer would appeal mainly to sophisticated buyers, but the response was strong and there were over 88,000 applications for a total of 759.2 million shares. The fixed price part of the offer was still more successful: it received 2.47

million applications for a total of 2.1 billion shares meaning that around 5% of the UK population owned shares in the company.

The result of the IPO was to broaden share ownership of BAA. In the 1988 Annual Report, it is stated that (despite some early sales) the then number of shareholders was still 1,064,815.

An important original feature of the privatization was a limitation of the maximum stake to be held by any one party to 15%. This both encouraged a wider ownership in the company and prevented its control by sectional interests such as individual airlines, or competitor businesses. The control was protected by a “golden share”. Such controls were however later declared incompatible with the free European market in capital by the EU, and the golden share provisions were dropped in 2003.

### **c) Political and Regulatory Environment and Objectives of the Privatization**

BAA’s privatization, in common with the privatizations of other UK utilities at the time – including British Telecom and British Gas – took place under the Conservative Government of 1979 onwards under the premiership of Margaret Thatcher. The privatization policy had several objectives:

- To transfer what were perceived as inefficient and overmanned state enterprises to the private sector
- To improve the service provided by those enterprises to the consumer
- To broaden share ownership

An objective which became important in later privatizations – to raise funds for Government – was not given a central role in BAA’s privatization, and indeed there was widespread criticism that utilities – including BAA – had been underpriced by the Government.

A further objective of other privatizations was the creation of competition. For example, the privatization of British Telecom coincided with the licensing of another operator, Cable and Wireless, to provide access to residential and business telephony markets. Prior to this, British Telecom had acted as a de facto monopoly. However, in the case of BAA, it was concluded each of the airports it owned had strong monopoly characteristics regardless of the ownership structure.

The rationale for privatizing BAA and other UK airports is set out in the Airports Policy White Paper (9.6):

*‘The Government is committed to converting as many as possible of Britain’s airports into private sector companies as part of its policy of reducing the role of the State. The Government is confident that the privatization of airports will bring substantial benefits. Besides reducing the size of the public sector, privatization will assist the Government’s objective of creating wider share ownership. It will also increase employee participation as, in line with previous privatizations, employees will be encouraged to buy shares at the time of sale. Privatization will also provide for greater freedom for management. For example, airports will have access to private capital. It will also encourage more innovative management, and lead to efficiency gains and greater responsiveness to customers. These benefits will have profound consequences for the future operation of airports in Britain’*

#### **d) Economic and Other Regulation**

Previous to BAA's privatization, BAA's airport charges were not governed by a formal system of economic and other regulation. Charges were set on an annual basis with the agreement of the Minister of Transport. The Airports Act set out the new basis for regulation of charges. The significant airports in UK –the three London airports (Heathrow, Stansted, and Gatwick) together with Manchester were subject to price regulation by the Civil Aviation Authority (CAA). Since then Manchester (with over 20m passengers) has been moved out of price controls, and this was also seriously considered for Stansted.

Although the legislation provides considerable flexibility, in practice, price caps are determined for regulatory periods of five years. The methodology employed was the RPI-X model which had recently been pioneered in the context of the privatization of British Telecom.

At the time of privatization, other regulatory models were considered, including rate of return regulation. The RPI-X approach with five year review periods was favored as it was considered that it provided better incentive qualities.

Price control regulation as applied in the UK is an extended and highly consultative process, which can extend over a considerable period. While ensuring that there are high levels of transparency and scrutiny, this has led to a complex and expensive process for all parties.

This regulatory framework has recently been reviewed and it is planned that a license system, similarly to that used for utilities in the UK, will be introduced, with greater flexibility for the regulator to set terms covering issues such as service, capital expenditure and financing, and an ability for the regulator to relax controls where they prove no longer to be necessary.

#### **e) Lessons Learned**

There have been a number of criticisms of the privatization of BAA. Firstly, as maximizing proceeds to the Government was not one of the main objectives at the time of the privatization, there have been subsequent suggestions that BAA may have been sold off too cheaply. While the unfamiliarity of airports as investments may have contributed to the low returns, they may also have arisen from the fact that an IPO rather than trade sale route was followed. Secondly, there have been criticisms of the decision to privatize BAA as a whole. A recent market investigation by the Competition Commission found that to increase competition, BAA should be split up and a number of airports, including Gatwick and Stansted, should be sold. Thirdly, there has been much debate about the regulatory regime implemented at the time of the privatization. While this originally produced low charges, it has been argued that, particularly in the absence of competition, this regime did not provide enough incentives for BAA to invest and to improve service standards, and consequently airlines have been critical of the level of service provided at BAA airports. More recently, BAA has invested substantially in improving service levels, notably through the opening of Terminal 5 at Heathrow, though this has led to substantial charges increases.

Key lessons include:

- A desire to follow broader objectives through privatization may well lead to reduced returns;
- A privatization may present an opportunity to restructure the airport sector in the area / country with the objective of enhancing competition. Such competition may be of increasing importance when the airports are in private hands and may provide scope for at least partial deregulation;

- Barriers to ownership (which may have originally arisen from commendable motives) may prove to be undesirable or unsustainable in the long run. Consideration should be given to whether they are entirely necessary or in the interests of airlines and passengers and how the consequences of them being ultimately removed could be managed;
- The design of the regulatory regime is of crucial importance. As well as ensuring that adequate controls are in place this needs to ensure that:
  - The process is reasonably manageable without leading to an expensive and onerous process, which may make it difficult for airlines to participate without undue cost and management resources;
  - Charges are not minimized at the expense of other considerations such as economic efficiency, and the ability of airports to invest to meet the needs of users; and
  - The incentives created by the regulatory regime are appropriate, promoting good service and investment without incorporating perverse incentives (such as to ‘gold plate’ investments).

#### **Relevance to Privatizations in a U.S. Context**

The privatization of a major national group of airports through an IPO is clearly very different from, the privatizations envisaged in the U.S. Nevertheless, the majority of these lessons are relevant to the U.S., though the significance of the final bullet point is reduced by the fact that formal regulation is less relevant in a U.S. environment where an equivalent role is played by airline agreements.

## BAA (acquisition by Ferrovial)

### a) Transaction Summary

Item	Description
Airport	BAA, including Heathrow, Gatwick (sold in 2009), Stansted, Glasgow, Edinburgh, Aberdeen and Southampton airports, plus interests in the U.S. and Italy.
Operational details	<p><b>2009 passengers:</b> 112 million (BAA total global passengers, excluding Gatwick which has now been sold).</p> <p><b>Principal airlines:</b> British Airways, BMI, easyJet, Ryanair.</p> <p><b>Configuration:</b>                      Heathrow: Two runways, five terminals.                      Gatwick: One runway, two terminals.                      Stansted: One runway, one terminal (three satellites).                      Glasgow: One runway, one terminal (three piers).                      Edinburgh: One main runway, one terminal.                      Aberdeen: One runway, one main passenger terminal, three helicopter terminals.                      Southampton: One runway, one terminal.</p>
Type of privatization transaction	Public tender offer. Freehold sale.
Interest	100%.
Date of transaction	June 2006.
Valuation	<p><b>Transaction value:</b> £10.1 billion (approx. US\$19 billion).</p> <p><b>Implied Enterprise Value:</b> £16.3 billion (approx. US\$31 billion) based on total consideration paid for shares plus the value of debt.</p> <p><b>EBITDA multiple:</b> 16.1x.</p>
Context	<ul style="list-style-type: none"> <li>• UK's biggest airport group.</li> <li>• Initially privatized in 1987.</li> <li>• Initial hostile takeover offer from Ferrovial, a Spanish construction company, was subsequently raised and recommended by BAA's Board.</li> </ul>

### b) Transactional and Governance Structure

As BAA was a company listed on the London Stock Exchange at the time of the acquisition, the timetable for the transaction was determined by the UK Takeover Code. This includes a number of key trigger points and dates, including:

- A shareholder increasing its interest in a public company above 29.9% must make an offer for this company.
- An offer document must be lodged within 28 days of announcing the offer.
- Any revision to the offer must be published within 46 days of the publication of the offer document.
- The 60<sup>th</sup> day after publication of the offer document is the last day on which an offer can be declared unconditional as to acceptances.

BAA was privatized with a ‘golden share’ which effectively gave the UK Government the final say over several types of major decisions such as takeovers or asset divestments. In 2003, the concept of a golden share was found to be illegal under EU law. Subsequently the UK Government divested itself of the BAA golden share at which point hostile takeover became possible. A similar withdrawal of a golden share led to the hostile takeover of Copenhagen Airport.

The offer made by Ferrovial in April 2006 (and increased subsequently) came with a number of conditions. The two most important of these were a minimum acceptance level of 90%, and the absence of proceedings commenced by EU competition authorities. In June 2006, Ferrovial announced that it held approximately 84% of BAA’s share capital. All conditions were either complied with or waived, and the offer was declared unconditional.

At the time of the takeover battle for BAA, it was rumored that several other bidders were interested in making an offer. However, after BAA’s Board decided to recommend Ferrovial’s increased offer of 935-pence-per-share, no other bidders came forward.

### **c) Political and Regulatory Environment and Objectives of the Privatization**

The transaction was a secondary sale rather than a privatization. It was not initiated or supported by the UK Government, and had originally been prevented by the “golden share” mechanism mentioned above.

The takeover offer was the result of a desire on the part of Ferrovial, the successful acquirer, to expand its interests in the airports sector. At the time of the transaction, Ferrovial explained to its investors that BAA was an attractive acquisition target as a result of its stable regulatory framework, high capital expenditure requirements and resilient revenues.

Following the acquisition, in March 2007, the Competition Commission commenced a market investigation, triggered by an investigation by the Office of Fair Trading which sought to determine whether the supply of airport services by BAA restricted or distorted competition in the UK. The UK institutions involved insist that this was not a response to foreign ownership of BAA, though at the very least the timing of the investigation appears to have been influenced by the presence of a bid. Nevertheless it may well be that the BAA precedent may make international investors more reluctant to invest in UK companies.

The findings of the investigation were published in March 2009, and included a requirement for BAA to sell Stansted and Gatwick, and either Glasgow or Edinburgh airport. BAA successfully challenged this outcome at the Competition Appeal Tribunal, on grounds of apparent bias. At the time of writing, an appropriate response to this judgment was being considered by all parties. However, BAA sold Gatwick to the Global Infrastructure Partnership prior to the Competition Appeal Tribunal Verdict.

### **d) Economic and Other Regulation**

At the time of the transaction, three of BAA’s airports (Heathrow, Gatwick and Stansted) were subject to price regulation by the Civil Aviation Authority (CAA). Price caps are determined for regulatory periods of five years. In June 2006, the CAA was consulting on price caps for the regulatory period 2008-2013. Ferrovial therefore took on the regulatory risk associated with the price cap determination process. Final price caps were announced in March 2008 for Heathrow and Gatwick, and in March 2009 for Stansted.

### **e) Lessons Learned**

This transaction was a secondary sale, in which a Spanish construction firm launched a hostile takeover of the publicly listed BAA. It is a consequence of the initial privatization by IPO, and the ending of the “golden share” arrangement, that the Government was not able to influence the ownership of BAA shares. In the wake of the acquisition of BAA by Ferrovial, concerns have been raised both about the level of debt used by Ferrovial to fund its acquisition, and about the monopoly position occupied by BAA airports.

- Under a full IPO arrangement, with the shares freely traded in the market, there are likely to be major limitations on the ability of Governments to exercise control over the identity of the airport’s shareholders, unless a “golden share” is maintained;
- Substantial care will need to be given to the design of any “golden share” or similar measure to ensure that it is sustainable into the long term;
- Any decisions to restructure the industry – for example to improve competition – are best undertaken prior to, or at the time of, privatization, where there will be no possibility of resulting loss to investors; and
- It may be desirable to include provisions on capital structure in airport regulation – as will be possible under the proposed new license based UK regulatory regime for airports.

### **Relevance to Privatizations in a U.S. Context**

BAA was originally the subject of a 100% IPO, and the Government’s clear preference was for the company shareholdings to be widely held. In the U.S. too, it may well be that the plans for an airport at the time of an original sale would be vulnerable to commercial decisions made in a free market. A number of the specific lessons are primarily related to the specific position of UK privatizations. However the need for care in any attempts to maintain control post privatization may well be relevant. The BAA experience may also indicate a need for very careful consideration of any potentially desirable long term restructuring of airport groups (for example to promote long term competition) before privatization takes place.

## Berlin Airports

### a) Transaction Summary

Item	Description
Airport	<b>Berlin Airports:</b> Schönefeld: To be re-opened as Brandenburg / BBI in 2011. Tegel: To be closed in 2011. Tempelhof: Closed in 2008.
Operational details	<b>2009 passengers:</b> Schönefeld: 7 million. Tegel: 14 million. Tempelhof: Closed in 2008.  <b>Principal airlines:</b> Air Berlin.  <b>Configuration:</b> Schönefeld: Will have two parallel runways and one terminal. Tegel: To be closed in 2011. Tempelhof: Closed in 2008.
Type of privatization transaction	Trade sale. Concession. Failed.
Interest	100%.
Date of transaction	1997 – 2003
Valuation	<b>Transaction value:</b> n.a. <b>Implied Enterprise Value:</b> n.a. <b>EBITDA multiple:</b> n.a.
Context	<ul style="list-style-type: none"> <li>• Berlin's three main airports, Schönefeld, Tegel and Tempelhof, were pooled within a single holding company in 1991.</li> <li>• In 1996, a decision was taken that Schönefeld would become the main airport for Berlin.</li> <li>• A new, privately funded international airport would be constructed on its site.</li> <li>• Privatization commenced in 1997.</li> </ul>

### b) Transactional and Governance Structure

The preparations for privatization effectively started in 1991 when Berlin's airports were merged together into a single company, BBF. The location of the new airport was decided upon in 1994. In 1996, the decision was taken that this airport should be privately funded by means of the privatization of the existing BBF and the new airport company BBI. The bidding process was complex and required the bidders to put substantial resources into providing detailed master plans and designs for the airport and also to provide full business plans as part of their offers. Partly as a result of the substantial nature of these initial requirements, offers were received in 1998 from only two bidders - consortia led by Hochtief advised by Fraport and IVG advised by Vienna Airport. Hochtief is a construction company with investments in infrastructure assets including airports. IVG is a real estate and asset management company.

In 2000, after a long battle in the courts over the process followed and the conduct of the bidders, the two consortia submitted a joint bid. The privatization was abandoned in 2003 due to a failure on the part of the buyers and sellers to agree on risks and financing.



The detailed conditions of the proposed sale were not made public. It is known, however, that the successful bidder would have been required to invest substantially in the new airport.

### **c) Political and Regulatory Environment and Objectives of the Privatization**

The main objective of the planned privatization was to obtain financing for the new airport on the Schönefeld site. Berlin was to become the first of a number of German airports to be privatized. Instead, Düsseldorf Airport became the first airport to be partially privatized, when a consortium including Hochtief and Aer Rianta acquired a 50% interest in 1997.

### **d) Economic and Other Regulation**

In Germany, each region has a degree of discretion to determine its own approach to aeronautical charges regulation, though there is a shared general framework. In the case of Berlin, temporary price cap regulation was developed in the late nineties. The intention was that aeronautical charges would be subject to price cap regulation post privatization, but these plans were abandoned once it transpired that the privatization would not proceed.

### **e) Lessons Learned**

This failed privatization suffered from three major setbacks. These were:

- A reluctance by potential bidders to shoulder the major costs of preparing a bid to the onerous specifications made by the company;
- A legal setback in relation to the manner in which the tender process was run. Complaints from an unsuccessful bidder, driven in part by the substantial costs they had incurred, were upheld in court; and
- A downturn in the global economy, and a subsequent failure of the buyers and sellers to agree on risks and financing. These issues may have been compounded by the fact that the construction of a new airport at significant cost was envisaged as part of this process.

Lessons learned include:

- Considerable consideration should be given to whether a complex and/or expensive and resource consuming bidding process is necessary or desirable. Substantial up front costs are likely to limit the field of bidders to the potential disadvantage of future airport users (who may be better served by a wider choice of well qualified potential new operators) as well as potentially reducing the returns to sellers;
- A tender process which will stand up to legal scrutiny is crucial to the successful completion of a privatization; and
- Privatizations can be made significantly more difficult where significant investment is required, particularly if the investment requirements are very ambitious and inflexible, and there are also substantial risks.

### **Relevance to Privatizations in a U.S. Context**

The problems of setting up a privatization process which includes sufficient scrutiny to ensure a high quality bidder with attractive plans for the airport - without creating a process which in itself deters some good bidders and thus reduces choice - is a complex and important one. Despite the fact that most U.S. privatizations will not involve major green field airport projects, these lessons appear potentially relevant.

## Brussels Airport

### a) Transaction Summary

Item	Description
Airport	The Brussels Airport Company.
Operational details	<b>2009 passengers:</b> 17 million. <b>Principal airlines:</b> Brussels Airlines, easyJet. <b>Configuration:</b> Three runways (two parallel). One terminal. Two piers.
Type of privatization transaction	Trade Sale. Freehold sale.
Interest	70%.
Date of transaction	December 2004.
Valuation	<b>Transaction value:</b> €735 million (approx. US\$ 977 million) as a single upfront payment. <b>Implied Enterprise Value:</b> €1.6 billion (approx. US\$ 2.1 billion) derived from the implied value of 100% of the equity and adding the value of debt.. <b>EBITDA multiple:</b> 12.3x.
Context	<ul style="list-style-type: none"> <li>• Pre-transaction, airport was owned by the Belgian State (64%) and Belgian financial institutions (36%).</li> <li>• Interest for sale was ‘up to 70%’, with the Belgian State wishing to retain at least 30%.</li> <li>• Other shareholders to base their decision to sell on the attractiveness of the offer.</li> </ul>

### b) Transactional and Governance Structure

The Belgian State and the other shareholders jointly appointed one financial advisor to conduct the sale of up to 70% of the shares. This advisor then designed the sale process, which consisted of two stages.

In the first stage, an information memorandum was produced and provided to interested parties in May 2004. Indicative bids were requested in June 2004. The Belgian State and other shareholders then compiled a shortlist of bidders who were taken into the second stage of the sale.

In this second stage, which commenced in July 2004, shortlisted bidders were given access to a data room which contained commercial, financial, and legal documentation pertaining to the airport. Final bids for the airport were due in September 2004. The Belgian State and other shareholders selected a preferred bidder, and approximately two months were dedicated to the negotiation of the final documentation, which meant the transaction was completed in December 2004.

The successful bidder was a consortium led by MAp (formerly known as Macquarie Airports). Other participating investors included the Macquarie European Infrastructure Fund and Macquarie Bank. The number or identity of competing bidders for Brussels Airport was not publicly announced as part of the sale process.

As part of the sale, the Belgian State granted the airport company an operating license for an indefinite period of time. A number of requirements were imposed upon the airport company as

part of this license, including the requirement to develop and maintain the airport infrastructure and the requirement to produce five-year business plans.

### **c) Political and Regulatory Environment and Objectives of the Privatization**

The fact that a number of different selling shareholders were involved in this transaction means that there were a number of objectives. For the Belgian financial institutions, who owned 36% of the airport prior to the sale, it is likely that the main objective was financial. In fact, the participation of these shareholders in the sale was not guaranteed at the start of the process, and depended on the attractiveness of the transaction terms.

It is likely, however, that the Belgian State had other objectives in addition to maximizing the proceeds from the transaction. First, the Belgian State indicated its intention to retain at least 30% of the shares in the airport after the transaction. It is therefore probable that the Belgian State assessed potential acquirers of the remaining shares for their suitability as a co-shareholder: the Belgian State had to have confidence it could cooperate successfully with the winning bidder. Second, considering the importance of the airport to the Brussels region and to Belgium as a whole, it is to be expected that the Belgian State took great interest in the business plans which potential acquirers were required to develop for the airport. Likewise, the track record and experience of potential acquirers in the area of airport ownership and operation is likely to have been one of the Belgian State's selection criteria.

### **d) Economic and Other Regulation**

The operating license also covers tariff regulation for Brussels Airport. This license provides the airport with the freedom to set charges provided these are agreed with airline users, and provided certain regulatory principles are followed. In the event of failure to agree there is provision for the regulator to require further consultation or ultimately to set prices directly.

An important principle included in the license deals with the degree to which regulated (i.e. aeronautical) activities are subsidized by non-regulated (i.e. non-aeronautical) activities. The license envisages that this cross-subsidy is reduced to zero over a period of four regulatory periods, i.e. over 20 years. It allows some scope for acceleration of this process in a scenario where charges at the airport are lower than charges at a defined set of comparable airports.

The implication of these provisions in the license is that airport charges are currently being set on a hybrid basis, and are moving to full dual till basis over time.

### **e) Lessons Learned**

The privatization of Brussels Airport is generally seen as successful, particularly in light of the proceeds raised by the Belgian Government as a result. The regulatory regime put in place as part of the privatization appears to have had sufficient flexibility to deal with the subsequent challenges faced by the airport, which included the economic downturn and changes in the airline community using the airport. Lessons learned include:

- Privatizing under a trade sale and applying a relatively straightforward process can raise significant proceeds for a Government, particularly in a strong economic climate;
- The presence of a continuing Government stake may not be a deterrent for a successful privatization, particularly if the private sector investor is allowed a controlling stake;
- It is possible for a regulatory regime to be driven primarily by negotiations between the parties, with the regulator acting only in a fall back role; and

- A well designed, flexible and robust light handed regulatory regime, incorporating clearly set out principles can be attractive to investors while still providing protection to users.

### **Relevance to Privatizations in a U.S. Context**

Although Brussels is a major capital city airport, its sale was a relatively simple and straightforward process in the context of privatization internationally. Although the US context may be different in a number of ways, the first of these bullet points may well be directly relevant to U.S. privatizations, while the second may become relevant in any cases where continuing stakes by cities or other agencies are considered. However, the differences in the role played by formal regulation in the U.S. may make the last two bullet points of less direct applicability.

## Budapest Airport

### a) Transaction Summary

Item	Description
Airport	Budapest Ferihegy International Airport.
Operational details	<b>2009 passengers:</b> 8 million. <b>Principal airlines:</b> Malév, easyJet, Air Berlin. <b>Configuration:</b> Two parallel runways. Three terminals.
Type of privatization transaction	Trade sale. Concession.
Interest	75%.
Date of transaction	December 2005.
Valuation	<b>Transaction value:</b> £1.3 billion (approx. US\$2.5 billion). <b>Implied Enterprise Value:</b> n.a. <b>EBITDA multiple:</b> 29.7x (based on forecast EBITDA for 2005 at the time of acquisition).
Context	<ul style="list-style-type: none"> <li>• Main airport in Hungary.</li> <li>• Intention to sell a majority interest announced in June 2005.</li> <li>• Interest for sale was 75%, with a possibility of this being increased to 100% either at the time of the privatization or subsequently.</li> <li>• Concession term 75 years.</li> </ul>

### b) Transactional and Governance Structure

The Budapest Airport privatization process started with a pre-qualification stage in June 2005. Once a long list of bidders had been selected, a process consisting of two further stages was announced. An information memorandum was circulated to bidders and indicative bids were requested by August 2005. A shortlist of bidders was then given access to due diligence materials in September and October 2005, with final bids due in November 2005. Transaction documentation was distributed to bidders as part of the due diligence process, allowing for swift completion post submission of final bids. BAA announced its acquisition of Budapest Airport on 18 December 2005.

The most important condition of the sale was the treatment of the 25% interest in Budapest Airport which remained with the Hungarian State post-privatization. Bidders were told that they would have pre-emption rights over this 25% interest, but also that the Hungarian State had a put-option and could force the successful acquirer to purchase this 25% interest at any time up until 31 December 2011 (subject to legislation being amended). This put option was exercisable at a price equivalent to price paid for the 75% interest, increased at 11.5% per annum.

As evidenced by the EBITDA multiple paid by the successful acquirer, this privatization took place at a time when infrastructure assets, and airports in particular, were in high demand. BAA was the successful acquirer of Budapest Airport. The number and identities of other bidders were not announced by the Hungarian State, but it is believed that many came forward at the initial stage of the process.

The asset management contract put in place as part of the privatization enabled the Hungarian State to transfer the operation of Budapest Airport to the private sector while ensuring that the fixed assets remained in State ownership, as required by law. Legislation was amended at the time of the

privatization to enable the Government to sell up to 100% of the shares in the airport if it wished to do so.

### **c) Political and Regulatory Environment and Objectives of the Privatization**

It is likely that the Hungarian State sought to fulfill a number of objectives as part of the privatization of Budapest Airport. Maximizing the transaction proceeds to the Hungarian State can reasonably be expected to be one of those objectives, particularly considering the undertakings given to bidders in relation to the availability of up to 100% of the shares. Given the importance of Budapest Airport to the Hungarian economy, it is probable that the bidders' plans for the future of the airport were also of key importance to the Hungarian State.

### **d) Economic and Other Regulation**

At the time of the privatization, the Hungarian State proposed a new regulatory regime for Budapest Airport. This envisaged the use of a price cap formula and an RPI-x mechanism. The value of x was to be set for six years (2006–2011), in Euros rather than Hungarian forint. The Hungarian State indicated a preference for self-regulation beyond 2011, with a default price cap of RPI–1%. Commercial revenues were not included in the determination of the price cap.

### **e) Lessons Learned**

The privatization of Budapest Airport occurred at a time when infrastructure was a very popular asset class with investors, and significant proceeds were raised by the Hungarian Government. The interest for sale, a majority stake with a possibility of acquiring 100% once the required legislation had been approved, proved to be attractive to investors. It should be noted that BAA subsequently sold its interest in Budapest Airport and a number of other non-UK airport assets following its acquisition by Ferrovial. Key lessons learned include:

- Privatizing using a relatively straightforward process can raise significant proceeds for a Government, particularly in a strong economic climate; and
- Mechanisms can be found to offer new owners substantially the same benefits as an outright sale while maintaining formal ownership on the part of the state.

### **Relevance to Privatizations in a U.S. Context**

The sale of Budapest took place in a very different central European economic and political environment from that of U.S. airports. Nevertheless, both of these lessons appear potentially relevant to U.S. privatizations

**Copenhagen Airport**  
a) Transaction Summary

Item	Description
Airport	Copenhagen Airport
Operational details	<b>2009 passengers:</b> 22 million. <b>Principal airlines:</b> SAS, Cimber Sterling, Norwegian Airlines. <b>Configuration:</b> Two parallel runways, one cross runway. Three interconnected passenger terminals.
Type of privatization transaction	Public tender offer. Freehold sale.
Interest	52.4%.
Date of transaction	October – December 2005.
Valuation	<b>Transaction value: Buyer's acquisition cost</b> A\$375 million (approx. US\$281 million). <b>Implied Enterprise Value:</b> n.a. <b>EBITDA multiple:</b> 10.3x
Context	<ul style="list-style-type: none"> <li>• Largest airport in Scandinavia.</li> <li>• Incorporated as a public company in 1990 and partially privatized in 1994 with a 25% IPO, followed by further sales in 1996 and 2000.</li> </ul>

**b) Transactional and Governance Structure**

Like BAA, Copenhagen had been privatized using an IPO mechanism (in this case, through successive partial sales) with ownership being protected by a mechanism equivalent to BAA's "golden share" preventing a single private shareholder from owning more than 10% of the shares. Unlike BAA, however, the Government retained a 39% stake in the company.

In May 2004 the Danish Government (like the UK Government in the case of BAA) was forced to relinquish its share ownership limits, making a takeover a possibility. In February 2005, Macquarie Airports announced that it had purchased an 11.3% stake in Københavns Lufthavn A/S through purchases in the open market. Further incremental purchases were made to take the stake to 14.7% by October 2005, when Macquarie Airports announced its intention to make a tender offer for the remainder for DKK 2,000 per share at a 31% premium to its previous share price, subject to securing majority control.

In December 2005, Macquarie Airports announced that the tendered offer had been successful and that it held 52.4% of the total shares. The Danish state chose to hold its stake in the company and remains the second largest shareholder, currently owning 39.2% of the shares.

As conditions for completing the tender offer, Macquarie Airports announced that it required more than 50% of the issued shares and voting rights and that all necessary regulatory approvals must be secured.

By moving quickly, Macquarie Airports became effectively the only party able to acquire a majority interest in Copenhagen Airport at this time. At the time of the transaction, Macquarie Airports, a fund formerly managed by Macquarie Bank, owned major stakes in Bristol Airport, Birmingham Airport (both UK), Aeroporti di Roma (Italy), Brussels Airport (Belgium) and Sydney Airport (Australia). The investment in Copenhagen Airport was seen as an opportunity to secure control of

a further major European capital city airport. The specialist airport fund was supported in its investment by other funds managed by Macquarie Bank, notably the Macquarie European Investment Fund 3 (MEIF3).

### **c) Political and Regulatory Environment and Objectives of the Privatization**

The Danish Government did not encourage or support an acquisition of a majority of the shares in Copenhagen Airport by Macquarie Airports. However, following the loss of its “golden share” the Government did not have any powers to prevent this from happening.

### **d) Economic and Other Regulation**

Formally the right to set airport prices lies with the Minister of Transport. Up until recently, however, prices were set for successive 3 year periods by relatively informal direct negotiations between the airport and airlines, subject to final approval by the Ministry. Subsequent to the acquisition of a majority interest by Macquarie Airports, the Danish CAA (SLV) adopted a more formal role as a regulator.

In 2008, following an extensive consultation with the airport and airlines, the SLV established a more formal framework for charges setting. This continued the previous approach of relying principally on direct negotiations to set prices, but also set out: a fixed timetable for discussions; specific requirements for information provision; and a ‘fall back position’ which the regulator would use to set prices in the event of non-agreement.

The fall back provisions, which would be expected to have a major influence on the expectations of parties, incorporated: 4 year pricing periods; use of a classic ‘building blocks’ regulatory approach; and a hybrid till approach under which aeronautical charges were subsidized by a proportion of non-aeronautical returns after all costs. In this case the proportion of commercial returns considered may vary between 10% and 50% depending on Copenhagen’s continuing competitiveness with other airports.

The first price setting under this arrangement took place in 2009 and concluded in a 5.5 year agreement between the airport and airlines covering prices and capital expenditure. This will be extended to service levels by further agreement during 2010.

### **e) Lessons Learned**

This transaction can effectively be described as a secondary sale, with Macquarie Airports purchasing the shares on the market many years after the initial privatization took place by means of an IPO. The fact that Copenhagen Airport’s shares were publicly listed, coupled with the loss of ownership restrictions, meant that the Government did not have any powers to prevent this transaction from occurring. Nevertheless, no major issues appear to have arisen since the purchase. Key lessons learned include:

- In an IPO scenario, the Government may not necessarily be able to exercise long-term control over the identity of the airport’s shareholders;
- The presence of a continuing Government stake is not necessarily a deterrent to investors in airports; and
- Light handed regulation can work effectively without the need for formal price controls, especially when combined with well defined fall back provisions in the event of failure to agree.



### **Relevance to Privatizations in a U.S. Context**

The Copenhagen transaction like (that involving BAA) was a market bid for a company which had already been privatized through an IPO, and where the preference of the Government on privatization was for a continuation of widely spread shareholdings in an autonomous company. The potential difficulties in maintaining controls post privatization may well ultimately be relevant for the U.S. The possibility of U.S. cities or other agencies retaining a stake post privatization may well also make the second bullet point relevant in some cases. The third bullet point covering regulation may be of lesser importance in the U.S. where the role of formal regulation is less significant.

## Delhi Airport

### a) Transaction Summary

Item	Description
Airport	Indira Gandhi International Airport, Delhi.
Operational details	<p><b>2008 passengers:</b> 24 million.</p> <p><b>Principal airlines:</b> Air India, GoAir, Indian Airlines.</p> <p><b>Configuration:</b> Three runways (one built since privatization), two main terminals (the 500,000m<sup>2</sup> Terminal 3 is to be inaugurated in July 2010).</p>
Type of privatization transaction	Trade sale. Concession.
Interest	74%.
Date of transaction	December 2005.
Valuation	<p><b>Transaction value:</b> Rs 150 crore upfront payment (approx. US\$32 million), plus mandatory capex, plus 46% revenue share.</p> <p><b>Implied Enterprise Value:</b> n.a.</p> <p><b>EBITDA multiple:</b> n.a.</p>
Context	<ul style="list-style-type: none"> <li>• In mid-2004, Airports Authority of India (AAI) invited bids for Delhi and Mumbai Airports.</li> <li>• Urgent need to ensure upgrading and addressing of shortage of capacity.</li> <li>• At Delhi, modernization required included a new international terminal.</li> </ul>

### b) Transactional and Governance Structure

When the process was first announced, the Indian Government expected to pick the winning bidders for Delhi and Mumbai Airports by the end of 2004. However, a number of delays were experienced. In September 2005, press reports indicated that five bidders had come forward for Delhi Airport, and that the successful bidder was to be selected by the year-end.

In December 2005, the Indian Government conducted a selection process by means of a technical evaluation and a financial evaluation. In the technical evaluation, the Indian Government assessed the bidding consortia's credentials in the areas of airport operation and development, and awarded scores in each area. The financial bids consisted of a revenue share percentage: each bidding consortium had been asked to propose a percentage of airport revenue which it would be willing to pass to AAI each year. In February 2006, the Indian Government announced its final decision to award the Delhi Airport project to the consortium led by GMR (a Bangalore-headquartered global infrastructure major with interests in the airports, energy, highways, and urban infrastructure sectors).

Shortly after the selection of the GMR consortium as successful bidder, the privatization was approved by the Cabinet. Once this approval had been obtained, a joint venture company was formed, with the GMR-led consortium as its majority shareholder (74%) and AAI as the minority shareholder (26%). It is interesting to note that one of the conditions of the privatization was that no foreign company could own more than 49% of the new joint venture company, which meant that all bidding consortia were led by Indian companies.

Two months after approval was received from Cabinet, in April 2006, the new joint venture company signed an operating, maintenance, and development agreement with AAI, with a total term of 60 years. This agreement covered, among other things, mandatory capital expenditure projects, service quality requirements, and details of the annual fee payable to AAI, i.e. 46% of revenues as per the GMR consortium's bid. In the same month, the joint venture company also signed a state support agreement with the Government of India. This agreement covered, among other things, the principles for tariff fixation.

Members of the GMR consortium included Fraport and Malaysia Airports Berhad. The number and identity of other bidders was never disclosed by the Indian Government, but when the proposed privatization was first announced, it was rumored in the press that ten bidders were interested in participating in the tender. Similarly, press speculation suggests that five bidders remained in September 2005. Of those five, two bidders reportedly passed the technical evaluation conducted by the Indian Government.

### **c) Political and Regulatory Environment and Objectives of the Privatization**

In its annual reports, the Indian Ministry of Civil Aviation outlines the key objectives of the privatizations of Delhi and Mumbai Airports. Private sector funding was sought to ensure the restructuring and modernization of the two airports. This is also evidenced by the mandatory capital expenditure schedules which potential acquirers were asked to commit to as part of their bid. In the case of Delhi, this included a new runway and a new terminal, to be completed by a defined date.

At the same time, the Indian Government had to safeguard the future of the other Indian airports within the control of AAI, many of which would not be financially viable without financial support sourced from larger airports such as Delhi and Mumbai. The revenue share approach, in which the successful acquirer commits to passing a certain percentage of its revenues to AAI each year, seeks to address this issue.

### **d) Economic and Other Regulation**

As the India's Airport Economic Regulatory Authority (AERA) had not been set up yet at the time of privatization, the state support agreement between the Government of India and Delhi Airport's new joint venture company only included relatively high-level principles in relation to the regulation of tariff. The agreement envisages a hybrid till regulation model, in which price caps are calculated based on the customary aeronautical building blocks (operating expenditure, depreciation and return on Regulatory Asset Base or RAB), less 30% of the non-aeronautical revenues generated by the airport. At the time of writing, AERA is in the process of consulting on a regulatory regime for all of India's airports. Its most recent consultation document indicates a preference for single till regulation, although there is an acknowledgment that agreements put in place at the time of the privatization of Delhi Airport will be taken into consideration.

### **e) Lessons Learned**

The privatization of Delhi Airport (and Mumbai Airport) presented an interesting challenge as these airports historically cross-subsidized some of the smaller loss-making airports in India. In addition, significant upfront investment in the airport infrastructure was required. For this reason the privatization was structured as a revenue share arrangement, without a significant upfront payment to the Government but with a commitment to pay a certain percentage of revenue to AAI each year.

This structure and the high level of revenue share bid by the successful acquirer currently presents a challenge for the implementation of an effective economic regulatory regime, since it provides a

considerable challenge to the viability of both continuing operations and new investment. Key lessons learned include:

- Structuring a privatization in an environment where there are substantial requirements for concession payments (for example to cross-subsidize smaller airports) and significant investment is likely to be challenging;
- A tender process leading to very high levels of concession payments can potentially cause longer term problems, since it may threaten the viability of airport operations or new investment (to the detriment of airport users) and cause issues in the design of effective economic regulation. There may be advantages in such circumstances in requiring bidding parties to produce a credible business plan which makes clear how the new buyers intend to secure such levels of payment without ultimately creating potential problems for airport users as a result of excessive pressures to cut costs and minimize capital expenditure;
- The regulation process must take into account the undertakings made by Governments at the time of privatization since otherwise investors will lose confidence in the future preparedness of regulatory institutions to ensure that their investment will be remunerated. This in turn will endanger the successful future privatizations of airports and other infrastructure; and
- Unless exceptional circumstances prevail, the form and conditions of the regulatory framework should be defined before privatization rather than after the sale.

#### **Relevance to Privatizations in a U.S. Context**

The problems of dealing with the consequences of seeking high concession payments for tenders may well be relevant for the U.S. in some contexts, as might be the difficulties of dealing with over-bidding based on overoptimistic business plans. The first two of these bullet points therefore appear potentially directly relevant to U.S. privatizations. The last two are less significant since the role of formal regulation in the U.S. is relatively limited.

## Japan Air Terminal

### a) Transaction Summary

Item	Description
Airport	Japan Air Terminal (JAT)
Operational details	<p><b>2009 passengers:</b> 61 million (at the main base of Tokyo International Airport (Haneda)).</p> <p><b>Principal airlines:</b> Japan Airlines (JAL), All Nippon Airlines (ANA).</p> <p><b>Configuration:</b> Two parallel runways, one cross runway. Fourth runway under construction. Three passenger terminals.</p>
Type of privatization transaction	On market purchase. Freehold sale.
Interest	19.9%.
Date of transaction	July – October 2007.
Valuation	<p><b>Transaction value:</b> Buyer's acquisition cost A\$475 million (approx. US\$388 million).</p> <p><b>Implied Enterprise Value:</b> n.a.</p> <p><b>EBITDA multiple:</b> n.a.</p>
Context	<ul style="list-style-type: none"> <li>• JAT was established in 1953 with the purpose of constructing, managing and operating the passenger terminals at Haneda Airport, Tokyo.</li> <li>• Runways are owned and operated by an separate Government body.</li> <li>• JAT subsequently secured responsibility for operating the retail and food and beverage businesses at Narita, Kansai, and Chubu airports.</li> <li>• Haneda Airport handles the majority of domestic flights to Tokyo, with Narita Airport handling the majority of international flights.</li> </ul>

### b) Transactional and Governance Structure

JAT was originally a private company, and in 1990 listed on the Tokyo Stock Exchange. In mid-2007, a consortium led by Macquarie Airports started making on-market purchases of shares in JAT. Prior to Macquarie Airports' involvement, share ownership had been dominated by Japanese corporates (including JAL and ANA), institutional investors, and pension funds.

The consortium led by Macquarie Airports made direct share purchases in the market. No formal purchase offer was made. The share levels disclosed over time were:

- 25 July 2007 – 9.56%;
- 13 September 2007 – 12.47%; and
- 24 October 2007 – 19.9% (of which 14.9% Macquarie Airports itself), becoming the largest single shareholder.

Macquarie Airports described its investment in JAT as a long-term strategic investment. However, any ambitions to replicate the ‘incremental/gradual’ market approach used by Macquarie Airports at Copenhagen Airport to secure a majority shareholding were quickly dampened by the Japanese government. On the announcement of Macquarie Airports increasing its shareholding to 19.9%, the Japanese Transport Minister raised concerns about the level of foreign ownership, suggesting that a cap should be put in place.

In May 2009, JAT announced its intention to buy back 22% of its shares (at 1,000 yen each) through an off market tender offer. Macquarie Airports offered its entire 14.9% stake to JAT and exited from its investment. Following its exit, Macquarie Airports suggested that the limited stake they had been able to secure effectively meant that they would not be able to adopt their preferred “active management” approach based on majority ownership.

### **c) Political and Regulatory Environment and Objectives of the Privatization**

Japan has a reputation for caution over foreign involvement in airports, with JAT as the only airport company where foreign ownership was possible. Other large Japanese airports remained under public ownership with the debate over foreign ownership levels at Japanese airports remaining a key issue in the proposed privatization of Narita Airport until this proposal was shelved by the new government in 2009.

However, in the wake of Macquarie Airports acquiring its 19.9% stake, the Japanese Government appeared divided over how to proceed. The Foreign Minister proposed plans to limit foreign ownership in Japanese airports to less than one-third (a shareholding of greater than one-third would allow blocking rights during votes). However, the Finance Ministry rejected this proposal, arguing it was at odds with Japan’s strategy to attract foreign investment to the country.

Many features of the Japanese Government involvement in JAT were informal and non-transparent. These may have resulted from a perception that the involvement of an active foreign investor would create loss of control and potential embarrassment. The subsequent departure of Macquarie is likely to have deterred at least some foreign investors from future participation in Japan.

### **d) Economic and Other Regulation**

Haneda levies two aeronautical charges:

- A Passenger Facilitation Charge paid by the passengers; and
- A Passenger Service Facility Charge paid by the airlines and intended to cover their share of facility costs.

Formally, both of these were set by the airport and monitored by Government. JAT submits any proposed price changes to the Government together with evidence of changed costs. The company would not proceed with price changes in the face of Government disapproval. In practice, this allowed JAT to maintain charges at a constant level indefinitely, though if resulting profits were seen as clearly ‘unreasonable’ the company might well face pressure to reduce them.

### **e) Lessons Learned**

The acquisition of an interest in JAT by Macquarie Airports was effectively a secondary sale which followed the initial listing of JAT on the stock exchange. It has highlighted to investors that foreign investment in airports is an area of controversy in Japan, although to date the Japanese Government has not introduced any measures to prevent it. Key lessons learned include:

- In an IPO scenario, the Government will not necessarily be able to exercise control over the identity of the airport's shareholders; and
- Investors are quite reasonably wary about investing in unfamiliar environments where there is a danger that protectionist measures may be imposed. Any such measures will inevitably impact their preparedness to invest in other airports or infrastructure more generally in the country concerned – potentially to the long term disadvantage of airport users.

#### **Relevance to Privatizations in a U.S. Context**

Although Government influence may be exercised in a very different way in Japan from that in the U.S., Governments at all levels may have strong preferences on the nature (and possibly nationality) of a future investors). Both of these lessons could therefore potentially be relevant to U.S. privatizations in some circumstances – particularly if overseas bidders seek to become involved.

## Juan Santamaría , Costa Rica

### a) Transaction Summary

Item	Description
Airport	Juan Santamaría Airport
Operational details	<b>2009 passengers:</b> 3.0 million. <b>Principal airlines:</b> TACA, Copa Airlines. <b>Configuration:</b> One runway, one terminal.
Type of privatization transaction	Trade sale. Concession.
Interest	100%
Date of transaction	2001
Valuation	<b>Transaction value:</b> US\$170 million investment commitment plus annual fees. <b>Implied Enterprise Value:</b> n.a <b>EBITDA multiple:</b> n.a
Context	<ul style="list-style-type: none"> <li>• With the privatization of Juan Santamaría Airport, the Costa Rica Government sought to achieve multiple objectives, including attracting private sector funding for expansion and renovation.</li> <li>• Lack of clarity in the regulatory framework combined with the global traffic downturn post 2001 led to a number of disputes and ultimately a change in ownership.</li> </ul>

### b) Transactional and Governance Structure

In 2001, a consortium consisting of Bechtel Enterprises and Airport Group International Holdings was awarded a 20 year concession to develop and manage Juan Santamaría Airport in Costa Rica. Bechtel Enterprises subsequently transferred its holding to its subsidiary Alterra Partners, a joint venture of Singapore Changi Airport Enterprise and Bechtel.

Under the concession agreements, a number of annual payments were due from the new airport operator to the Government, including passenger fees, air traffic control fees and a US\$1 million per year concession fee. In addition, the new airport operator assumed responsibility for all financial obligations associated with the master plan, estimated to amount to US\$170 million. The new operator was required to complete the terminal improvements based on designs and work that had been initiated by the Government.

In the period between 2001 and 2009, a number of difficulties arose. Press speculation suggests that in 2003, there was a disagreement between Alterra Partners and the Costa Rica Government about the interpretation of the economic regulatory framework of airport charges. Alterra Partners claimed that a substantial amount of revenue had been lost as a result. The company reportedly struggled to meet its financial obligations and did not complete the renovations envisaged in the master plan agreed at the time of the award of the concession.

In addition, it appears there were a number of Government agencies involved in the privatization and the subsequent management of the concession. This seems to have resulted in confusion and a relatively heavy-handed approach to oversight, with Government officials retaining many residual controls.



In July 2009, the shareholders of Alterra Partners decided to sell their interest in Juan Santamaría Airport to a consortium consisting of Houston Airport System, the Canadian company ADC and the Brazilian company Andrade Gutierrez Concessoes. The name of Alterra Partners was changed to Aeris Holding. The expansion of the airport is due to be finalised in November 2010, five and a half years later than originally planned. It is understood that the new shareholders took over the outstanding debt and penalties, but received a new 25 year concession in return.

### **c) Political and Regulatory Environment and Objectives of the Privatization**

It appears that the Costa Rica Government was seeking to achieve a number of objectives as part of the privatization of Juan Santamaría Airport. Firstly, investment was required in the renovation and expansion of the airport facilities, and the Government wanted to attract private sector funding to realize this. Secondly, the Government wanted to retain the ultimate ownership of the airport assets. Thirdly, the Government wanted to strengthen the management of the Airport, which had a weak, decentralized management structure and a poor safety record. Finally, the Government wanted to receive ongoing revenues in the form of concession payments and other fees from the airport.

### **d) Economic and Other Regulation**

The regulatory framework developed as part of the Juan Santamaría Airport privatization was unusual in that it was in principle a dual till framework, but additional regulation was developed to cover fees charges by the airport for non-aeronautical services.

Aeronautical charges at the airport were regulated by means of a price cap framework, with the maximum charge increasing each year by US inflation, less an efficiency factor, plus a separate allowance for capital expenditure. The efficiency factor was determined in advance for each year to 2006. There was also a provision to allow for recovery of income in subsequent years, if competitive pressures meant that actual charges were below the price cap.

In relation to non-aeronautical services, the airport operator was required to produce detailed financial reports each year to demonstrate that its fees were in line with average fees for the same services at similar airports.

It seems that there was a lack of clarity in the design of the economic regulatory framework, as it was reported in the press that in 2003, there were disputes between the airport operator and the Government in relation to the maximum tariffs the airport was allowed to charge. It is likely that the global downturn in traffic following 2001 exacerbated these difficulties.

There was also a lack of clarity in the concession agreement, which provided for detailed regulation by multiple Government agencies of operational matters that are typically delegated by the seller to the new operator. This level of oversight by multiple regulators without a clear delegation of authority and responsibility added uncertainty to the both the process and the future prospects for successful operation.

### **e) Lessons Learned**

The privatization of Juan Santamaría Airport encountered issues similar to those encountered as part of the privatization of Argentina's airports. There was a downturn in traffic, a concession fee fixed in US dollars, and in this case the economic regulation of airport charges appears to have lacked the desired clarity. Key lessons learned include:

- Any concession agreement will only work successfully in securing the development of airports if the investment required remains viable. Care must be taken in the design of concession terms to ensure that this is the case even in adverse circumstances;

- Major construction is likely to entail a significant increase in charges – especially if the charges in place before the privatization were set at non-viable levels. The seller should ensure that the implications of this are understood and evaluated in the sales process, and consider consulting the airlines in advance.
- Airport concession agreements should include clear statements of the new airport operator’s rights and obligations, and a clear statement of the roles and responsibilities of regulators; and
- A clear framework for the determination of aeronautical charges is crucial to avoid future disputes.

### **Relevance to Privatizations in a U.S. Context**

All of these lessons are potentially relevant to U.S. privatizations, although the role of airlines on final decisions on investments and their relationship to price may mean that the concerns over the impact major construction raised in the second bullet point are mitigated within the Airport Privatization Pilot Program process.

## London Gatwick Airport

### a) Transaction Summary

Item	Description
Airport	Gatwick Airport
Operational details	<b>2009 passengers:</b> 32 million. <b>Principal airlines:</b> easyJet, Flybe. <b>Configuration:</b> Single runway, two terminals.
Type of privatization transaction	Trade sale. Freehold sale.
Interest	100%.
Date of transaction	December 2009.
Valuation	<b>Transaction value:</b> £1.5 billion (approx. US\$ 2.5 billion). <b>Implied Enterprise Value:</b> n.a. <b>EBITDA multiple:</b> 9.4x
Context	<ul style="list-style-type: none"> <li>• Second largest airport in the UK.</li> <li>• Previously owned and operated by BAA.</li> <li>• In June 2006, a consortium led by Ferrovial, acquired BAA and the company was subsequently de-listed.</li> </ul>

### b) Transactional and Governance Structure

In March 2009, the Competition Commission ruled that BAA must sell Gatwick Airport. This ruling was subsequently overturned, as described in section c), but Ferrovial had chosen to pre-empt the Competition Commission's ruling and started a sale process in September 2008.

When Ferrovial commenced the sales process, it was reported to be seeking offers in the region of £1.8bn-£2 billion, an amount in excess of the Regulatory Asset Base (RAB) of £1.6bn. However, once the sale process commenced the range of offers submitted to Ferrovial were reported to be at a significant discount to the RAB, some as low as £1.2 billion. In addition to operational difficulties at the airport, the timing of the sale at the peak of the credit crisis and corresponding drops in air traffic levels meant that many of the bidding parties had difficulty in securing the necessary financing.

Several potential bidders initially expressed interest in acquiring Gatwick Airport, including pension funds, airport investment groups, airport operators and even airlines such as Virgin Atlantic. However, only three groups made it to the final stage of bidding:

- Global Infrastructure Partners (GIP), a consortium backed by Credit Suisse and General Electric;
- A consortium including Manchester Airport Group (MAG) and Borealis; and
- Lysander, a consortium led by Citi Infrastructure Partners (who previously expressed interest in Chicago Midway).

All three final bids were reported to be at significant discounts to the RAB, ranging from £1.18 billion to £1.4 billion, and were reported to have been rejected by Ferrovial. However, on 21

October 2009, Global Infrastructure Partnership was announced as the successful party with a winning bid of £1.51bn, roughly equating to a 6% discount to the RAB.

In its 2009 annual results, BAA reported a £277.3 million loss from the sale.

Since formally taking control of Gatwick Airport on 4 December 2009, GIP has sold down equity stakes in the airport to two parties: a 12% stake to National Pension Service, a Korean pension fund and the world's fifth largest pension fund, at a value of under £100million; and a 15% stake to the Abu Dhabi Investment Authority, a sovereign wealth fund.

### **c) Political and Regulatory Environment and Objectives of the Privatization**

In March 2009, the Competition Commission ruled that BAA must sell Gatwick, Stansted and either Edinburgh or Glasgow Airports within two years. This finding came in response to concerns raised by the Office of Fair Trading over BAA's perceived monopoly of airport services in the UK and in particular in the South East of England and Lowland Scotland. In 2008, BAA Airports handled 62% of passengers travelling in the UK and faced criticism that its effective monopoly resulted in lack of investment and compromised service levels.

Ferrovial chose to pre-empt the Competition Commission's ruling and on 17 September 2008 announced its intention to sell Gatwick Airport. It was speculated that Ferrovial opted to bring forward the sales process in order to raise funds to help repay £1billion in debt facilities held by BAA, due for repayment in March 2010.

It should be noted that following the completion of the sale process, the Competition Tribunal upheld BAA's complaint that the Competition Commission's recommendations on the break up of BAA were invalid as a result of the inclusion on the Panel of an advisor who had links with one of the potential bidders.

The Gatwick Airport transaction occurred in a period of great economic uncertainty. The airport's traffic figures had been steadily declining since the beginning of the 2008 summer season, with several airlines ceasing operations entirely. This was the result of challenging global market conditions due to high oil prices and global recession and the shift of transatlantic traffic to Heathrow airport following the Open Skies agreement. Bidders had to make difficult assumptions on how quickly they expected traffic levels to recover.

One of the key issues during the transaction was what assumptions to make on the construction of a new runway within the London airport system, with airfield capacity currently acting as one of the primary constraints on future growth. Furthermore, it was suggested that Gatwick Airport could be removed from price controls (de-designated) following its separation from BAA – a process which would be enhanced by the scope for competition following the construction of further runway capacity in the South East system (initially at Heathrow and Stansted). In practice, however, the new British Government elected to in May 2010 announced that it will not allow the building of a new runway in the London system, leaving questions over how capacity issues will be addressed, and the opportunities for competition unanswered.

#### **d) Economic and Other Regulation**

At the time of the transaction, Gatwick was subject to price regulation by the Civil Aviation Authority (CAA). Price caps are determined for regulatory periods of five years based on single till regulation.

This regulatory framework has recently been reviewed and it is planned that a license system, similarly to that used for utilities in the UK, will be introduced, with greater flexibility for the regulator to set terms covering issues such as service, capital expenditure and financing, and an ability for the regulator to relax controls where they prove no longer to be necessary. It may well be that Gatwick as a separate company competing for traffic, will be removed from regulation in due course. At the very least, there is scope for lessening the level of controls and moving towards a more light handed form of regulation

#### **e) Lessons Learned**

The Gatwick Airport secondary sale was a transaction which took place in challenging circumstances. There were uncertainties associated with the decision on the location of the next runway in the London area, and economic conditions were challenging. For these reasons, it was not possible for the seller to achieve a premium to the regulatory asset base (RAB). However, it is generally seen as a significant achievement to achieve a sale in the face of these uncertainties. The key lesson learned is:

- Where investors can be convinced of the overall quality of an asset and the strength of its regulatory institutions, transactions can be achieved even in uncertain circumstances. However, the valuation achieved in such circumstances is likely to be lower.

#### **Relevance to Privatizations in a U.S. Context**

In this case the transaction was a secondary sale between two private companies of a company which had been originally privatized some time previously. The lesson learned has been limited to the saleability of good assets even in adverse conditions – which would appear to be relevant to future U.S. privatizations.

## Manila Airport

### a) Transaction Summary

Item	Description
Airport	Manila Airport Terminal 3
Operational details	<b>2009 passengers:</b> 24 million. <b>Principal airlines:</b> Cebu Pacific, Philippine Airlines <b>Configuration:</b> Two runways and three terminals.
Type of privatization transaction	Trade sale. Concession. Failed.
Interest	100%.
Date of transaction	1999.
Valuation	<b>Transaction value:</b> n.a. <b>Implied Enterprise Value:</b> n.a. <b>EBITDA multiple:</b> n.a.
Context	<ul style="list-style-type: none"> <li>• Terminal 3 at Manila Airport was approved for construction in 1997.</li> <li>• A build-operate-transfer contract was awarded to a private sector partner.</li> <li>• A contract was signed in 1999 but a series of legal disputes followed.</li> </ul>

### b) Transactional and Governance Structure

The third terminal at Manila Airport in the Philippines was approved for construction in 1997. It was the intention of the Government at that time to award a build-operate-transfer contract for Terminal 3 to a private sector partner.

In 1999, a consortium led by Fraport, which included Deutsche Bank and the Asian Development Bank, signed an agreement with the Government which envisaged the consortium funding the construction of the terminal, and in return being able to operate it profitably for a period of 25 years. Shortly thereafter, it is believed that the Philippine Government offered to buy out the consortium led by Fraport for US\$400 million. Fraport turned this down as being inadequate and onerous and legal disputes began.

Terminal 3 was seized by the Philippine Government in 2004. Fraport and its consortium partners received a compensation payment which is reported to be far below the cost associated with constructing the terminal, and a further €41.9 million was paid to Fraport under a Federal government investment guarantee for capital investments outside Germany.

The names of any other bidders for the build-operate-transfer contract were not disclosed.

### c) Political and Regulatory Environment and Objectives of the Privatization

The main objective of this privatization was to secure private funding for the construction of Terminal 3. The project was the first major project finance project in the Asia-Pacific region.

However, Government policy in the Philippines changed when the Government changed. For example, it is believed that the initial intention was for Philippine Airlines to relocate to Terminal 3, and that Terminal 3 should have exclusivity of international traffic. This subsequently became uncertain. An initial attempt by the Government to buy out the Fraport-led consortium ultimately resulted in a series of legal disputes. The built-operate-transfer contract was said to be incompatible

with certain aspects of Philippine law. The disputes went on for many years, and the consortium led by Fraport has incurred significant losses as a result.

#### **d) Economic and Other Regulation**

The regulatory environment in which the build-operate-transfer contract award for Manila Terminal 3 took place is not publicly known. It is believed, however, that disputes around passenger charges arose after the contract award. A departure tax of US\$20 per passenger was reduced to US\$11, making the project more difficult to finance.

#### **e) Lessons Learned**

The failed privatization of Manila Terminal 3 illustrates the risks associated with a change in Government during or shortly after a privatization. If the objectives of the new Government are not the same as those of the outgoing Government, and if the legal system and documentation surrounding the privatization is not sufficiently robust, significant issues can arise for investors and other airport stakeholders. Key lessons learned include:

- When privatization is being considered, where possible ensure broad political support to guarantee a stable process, particularly where the privatization process is likely to be lengthy and/or involves significant investment in the construction of new infrastructure;
- Investors are quite reasonably wary about investing in unfamiliar environments where there is a danger that protectionist measures may be imposed. Any such measures will inevitably impact on their preparedness to invest in other airports or infrastructure more generally in the country concerned to the potential long term disadvantage of airport users and the community more widely; and
- To enhance investor confidence and preparedness to bid, and thus to increase the choice of potential new operators to the potential benefit of users, the legal and contractual arrangements associated with the privatization should build in provisions to protect investors (in the form of rights to compensation) even in the event of a change of Government scenario.

#### **Relevance to Privatizations in a U.S. Context**

The general investment environment and the extent of sovereign risk are very different in the Philippines from that of the U.S. The direct lessons learned are accordingly limited. Nevertheless, overseas investors, in particular, are likely to perceive a degree of potential risk in an unfamiliar U.S. privatization program – particularly in its early stages. The Manila experience therefore dramatizes concerns which will also be felt to a more limited extent in privatizations in the U.S. (or in any other country).

## Mexican airports

### a) Transaction Summary

Item	Description
Airport	34 airports divided into three groups. Includes Cancun, Guadalajara and Monterrey.
Operational details	<p><b>2009 passengers:</b> 47 million in total. Cancun: 11 million; Guadalajara: 6 million; Monterrey: 5 million</p> <p><b>Principal airlines:</b> Aeroméxico, Mexicana.</p> <p><b>Configuration:</b> 34 airports in total. The largest airport, Cancun has two runways and three terminals.</p>
Type of privatization transaction	Trade sale followed by IPO. Concession.
Interest	Initially 15%.
Date of transaction	1998, 1999, 2000, 2006
Valuation	<p><b>Transaction value:</b></p> <ul style="list-style-type: none"> <li>• 15% interest in South-East Group: Ps. 1,165 million (approx. US\$120 million).</li> <li>• 15% interest in Pacific Group: Ps. 2,453 million (approx. US\$261 million).</li> <li>• 15% interest in North-Central Group: Ps. 864 million (approx. US \$88 million).</li> </ul> <p><b>Implied Enterprise Value:</b> n.a.</p> <p><b>EBITDA multiple:</b> n.a.</p>
Context	<ul style="list-style-type: none"> <li>• As part of the privatization, the country's airports were divided into four groups.</li> <li>• A 15% interest in three of these groups was sold to strategic partners.</li> <li>• Mexico City Airport and a total of 19 small airports remained Government-owned.</li> </ul>

### b) Transactional and Governance Structure

In 1998, the Secretariat of Communications and Transport (Secretaria de Comunicaciones y Transportes – SCT) published the general guidelines for the participation of the private sector into the Mexican Airports System (Sistema Aeroportuario Mexicano – SAM). As part of this effort, the 58 federally controlled airports were regrouped into five separate administrative entities. The entities included:

- GAP – Pacific Airports Group (Grupo Aeroportuario del Pacifico)
  - 12 Airports, including Guadalajara
- OMA – Central and Northern Airports Group (Grupo Aeroportuario del Centro Norte; known as OMA from 2007 onwards)
  - 13 Airports, including Monterrey
- ASUR – South Eastern Airports Group (Aeropuertos del Sureste de Mexico)
  - 9 Airports, including Cancun
- Mexico City International Airport (Aeropuerto Internacional de la Ciudad de Mexico – AICM)



- Remaining Airports
  - 19 Airports in total
  - Less economically viable

The intent was to privatize the first four entities, which contained the airports with the greatest share of traffic and the most opportunity for growth. Airports in the fifth group were to be run by Aeropuertos y Servicios Auxiliares (ASA). Mexico City International Airport (MEX) continues to be operated by ASA, after social and political problems obstructed the transition efforts.

When the airport groups were created and privatized, the Mexican Government was the principal owner, and controlled 85% of the shares in each group. The remaining 15% of the shares were to be sold to a strategic partner, which was required to be a consortium comprised of 1) a Mexican partner, controlling at least 25.5% of the shares, 2) an Operator partner, controlling at least 25.5% of the shares, and one or more additional investor partners controlling the remaining 49.0% of the shares.

ASUR was established in December 1998, with a consortium called Inversiones y Tecnicas Aeroportuarias bidding \$120 million for the 15% stake in the entity. The Mexican Government sold 74% of the company shares in September 2000, followed by another 11% in March, 2005.

Ownership of the company is currently split between:

- The Consortium (comprised of Fernando Chico Pardo and Københavns Lufthavn A/S of Denmark) which owns 7.65% of the stock
- Agrupación Aeroportuaria Internacional, which owns 25.3%
- The remainder is traded on the Bolsa Mexicana de Valores (BMV) and the New York Stock Exchange (NYSE).

The winning tender for the 15% share of GAP was accepted in August 1999, at an amount of \$261 million. The strategic partner is Aeropuertos Mexicanos del Pacifico, which continues to hold a 15% stake in the company, and is currently comprised of Desarrollo de Concesiones Aeroportuarias, Corporacion Mexicana de Aeroportos, and AENA International. Each of these three companies owns a 5% stake in the entity. The government controlled shares were sold in February 2006.

OMA was established in June 2000, with the strategic partner (SETA) bidding \$88 million for the 15% stake. SETA is currently comprised of ICA Aeroinvest and Aeroports de Paris Management, and owns 16.7% of total stock in the company. The remainder is owned by ICA Aeroinvest, which invested further in the entity when it exercised a call option in December 2005 that it had with the Mexican Government to purchase an additional stake in the company. Today, ICA Aeroinvest owns 42% of the company, in addition to the stake that it has through SETA. The remaining shares are owned by institutional and individual investors that have purchased them on the BMV or the NYSE after the Mexican Government auctioned its remaining shares in November 2006.

### **c) Political and Regulatory Environment and Objectives of the Privatization**

The Mexican Airport Law 1995 enables the Mexican Ministry of Communications and Transportation to grant concessions for the construction, operation, maintenance and development of public service airports in Mexico. Such concessions must generally be granted by means of a public bidding process. However, this is not required where the prospective concessionaire is a 'federal public administration' entity. This enabled the Mexican Government to grant concessions without bidding to the four groups of airports which were established in 1997-98. However, the

subsequent selling of 15% interests to strategic partners was conducted through a public bidding process, in which bidding consortia were required to have both Mexican and foreign participation. The objective of the Mexican Airport Law and the subsequent privatization of the airports was to promote the expansion, development and modernization of Mexico's airport infrastructure by encouraging investment and competition. The Mexican Government also benefited from the sale proceeds, and from the improvements in efficiency identified by the strategic partners.

#### **d) Economic and Other Regulation**

The Mexican Ministry of Communications and Transportation is responsible for price regulation. This has been the case since 1999, when the Mexican Antitrust Commission issued a ruling that airport markets are not generally competitive. In the same year, a framework for price regulation was incorporated in the concessions for the Mexican airports.

Maximum prices are set for five-yearly periods. The methodology adopted in the regulation is a forward-looking one which does not rely on a RAB x WACC calculation. Instead aeronautical charges are set at the constant level that ensures that discounted future real aeronautical cash flows (income – operating costs – CapEx) are equal to a pre-determined reference value. The cost of capital to be used for regulatory purposes should be established using 'internationally accepted measures' though at a minimum it should be based on the yield on long-dated Mexican US dollar denominated bonds plus a Mexican airports risk premium. Maximum prices are adjusted downward each year by applying an efficiency factor. Non-aeronautical revenues are not taken into account, i.e. the framework can be described as dual till.

#### **e) Lessons Learned**

The privatization of Mexico's airports was unusual in that the airports were divided into five groups, three of which were privatized more or less simultaneously by means of attracting strategic investors for a 15% interest in the groups. The structure of this privatization has allowed smaller, less commercially viable airports to continue to be cross-subsidized by larger airports, but within the framework of private ownership. The Mexican regulatory regime is now well-established and appears to be working well, although there have been suggestions that the regime favours airports over their airline customers. Key lessons learned include:

- It is possible to privatize a country's airports while at the same time ensuring the ongoing provision of services at airports that are less commercially viable;
- Privatization provides an opportunity for restructuring airport systems to a form which promotes competition, without subsequently disadvantaging investors after the sale has taken place; and
- A stable predictable regulatory regime has promoted substantial expenditure on the development of Mexico's airport system.

#### **Relevance to Privatizations in a U.S. Context**

Airport privatization in Mexico employed an approach that was, at the time, highly innovative, and appears with hindsight to have worked well. Although the privatizations envisaged in the U.S. are very different from the break up and sale of a national group, there are still lessons which may be relevant to U.S. privatizations of airport groups. The first two of these bullet points appear relevant to some U.S. privatizations, particularly if they involve airport groups. The last is potentially of less significance since the role played by formal external regulation in price setting in the U.S. is more limited.

## Naples Airport

### a) Transaction Summary

Item	Description
Airport	Naples Airport.
Operational details	<b>2009 passengers:</b> 5 million. <b>Principal airlines:</b> Alitalia, easyJet. <b>Configuration:</b> One runway, two terminals.
Type of privatization transaction	Trade sale. Concession.
Interest	70%.
Date of transaction	August 1997.
Valuation	<b>Transaction value:</b> £17 million (approx. US\$ 28 million). <b>Implied Enterprise Value:</b> n.a. <b>EBITDA multiple:</b> n.a.
Context	<ul style="list-style-type: none"> <li>• First airport in Italy to be privatized in 1997.</li> <li>• 70% interest sold to BAA which had already been involved in master planning at the airport.</li> <li>• 40 year management contract awarded in 2003.</li> </ul>

### b) Transactional and Governance Structure

In 1995, the company managing Naples Airport (GESAC) worked together with BAA to draw up a master plan for the airport. In 1997, BAA acquired 70% of the shares in GESAC from the City and Province of Naples. In 1999, BAA sold 5% of this interest to Interporto Campania of Nola. A 40 year management contract for Naples Airport was awarded to GESAC in 2003.

No competitive process was held at the time of the privatization of Naples Airport. This was the first airport privatization in Italy, and it took place before the significant increase in demand for airports and other infrastructure assets in the early 21<sup>st</sup> century. Moreover, the objectives of the state agencies involved in the privatization of Naples Airport were principally related to the realization of the master plan for the airport. As BAA had been heavily involved in the development of this master plan, the company was an obvious candidate for the acquisition of an interest in the airport.

The company remains majority owned by BAA (65%). The other shareholders are City of Naples (12.5%), Province of Naples (12.5%), SEA (5%) and Interporto Campano (5%).

### c) Political and Regulatory Environment and Objectives of the Privatization

In August of 1997, the City of Naples and the Province of Naples each sold a 35% interest in GESAC, the Naples Airport management company, to BAA. The state agencies made the decision to privatize because they believed that private management was of strategic importance for the future development of the airport, and of the region around it.

BAA has been closely involved with GESAC since participating in a master planning exercise in 1995. As a result of this exercise, a twenty-year development plan was put in place. It is likely that BAA's engagement in this process gave the relevant state agencies confidence in BAA's capabilities in the areas of airport operation

In 2009, the privatization was described as a success during the opening ceremony of the new airport terminal. The associated press release states that €209 million has been invested in the airport by GESAC, including new passenger and cargo terminals, parking facilities, access roads and baggage handling equipment.

#### **d) Economic and Other Regulation**

No regulatory regime governing airport charges at Naples Airport was in place at the time of the sale of a 70% interest to BAA. Since then, regulation in Italy has been evolving, in a complex process involving a number of parties including the Italian Civil Aviation Authority ENAC. ENAC was established in July 1997 and now effectively has responsibility for the day to day implementation of the regulatory system.

The system that is now in the process of implementation at individual airports is of a CPI-X type including the following features:

- Based on building block costs – e.g. operating costs and return of and on capital;
- Four year approval periods;
- Based on the costs of the aviation till less 50% of the margin (in this case defined as returns after all costs including the cost of capital) arising from commercial activities; and
- A specific term for new infrastructure.

This is to be put into effect on an airport by airport basis in a regulatory contract which also covers investment and service requirements. Naples Airport has pro-actively taken steps to secure an early regulatory contract with ENAC leading to a 40% increase in charges between 2007 and 2012.

#### **e) Lessons Learned**

The Naples Airport privatization was one of the earlier airport privatizations in Europe. It took place in 1997, but before then the acquirer, BAA, was already closely involved in the master planning of Naples Airport. The regulatory regime in Italy has taken a long time to develop. There was a long period of uncertainty in relation to the regulatory regime, during which time aeronautical charges in Italy did not increase. A 40% increase in charges at Naples Airport has recently been agreed and is being phased in. Key lessons learned include:

- Close cooperation between the airport and its future private shareholder can smooth the way to privatization;
- Uncertainty in relation to the regulatory regime makes an airport less attractive to investors;
- The introduction of formal regulation can offer the opportunity for the airport to secure price increases to recover legitimate costs in a way which was not possible in the absence of a clear mechanism; and
- Where a regulatory regime offers the prospect of a secure, stable and predictable regulation it may be welcomed by airports and their investors.

#### **Relevance to Privatizations in a U.S. Context**

Although the context will be different in each case, the first of these lessons is likely to be relevant to some privatizations. The remainder are of less significance since the role of formal external regulation in the U.S. is more limited.

## Rome

### a) Transaction Summary

Item	Description
Airport	Aeroporti di Roma (AdR) consisting of Rome Fiumicino and Rome Ciampino.
Operational details	Rome Fiumicino has three interconnected terminals and three runways. Ciampino has one runway and one terminal.
Type of privatization transaction	Successively: <ul style="list-style-type: none"> <li>• A partial initial public offering.</li> <li>• A trade sale leading to a takeover of the listed component.</li> <li>• A secondary sale.</li> <li>• A further secondary sale.</li> </ul>
Interest	Initially 45.5%.
Date of transaction	Between 1997 and 2007
Valuation	Various.
Context	<ul style="list-style-type: none"> <li>• Concession to operate and manage the two Rome airports of Ciampino and Fiumicino awarded to AdR in 1974.</li> <li>• Series of privatization / secondary sale transactions subsequently.</li> </ul>

### b) Transactional and Governance Structure

AdR was awarded the concession to operate and manage the two Rome airports of Ciampino and Fiumicino in 1974. In 2000, this concession was extended until 2044. In 1997, the Italian Government listed 45.5% of the shares in AdR on the Italian stock exchange. In 2000, the Italian Government sought trade buyers for a further 51% stake. Following a competitive process, the winner was Leonardo, a consortium led by Gemina, a listed Italian company. Other companies within Leonardo were Falck S.P.A, Compagna Italtroli S.p.A. and Impregilo. Under listing rules, Gemina was required to make an offer for the listed shares resulting in it holding 93% of the total shareholding.

Subsequently, Gemina sold 44.7% of its shareholding to infrastructure funds controlled by Macquarie Bank (MAP, MAG and GIF) in 2003. In 2007, the Macquarie funds sold their stake in AdR to a consortium of Italian industrial interests.

### c) Political and Regulatory Environment and Objectives of the Privatization

The objectives of the AdR company as a private entity are set out within the 1997 Prospectus. The company intended to:

- ‘Maintain and secure its position within the top tier of consistently profitable airports in the world
- ‘...continue to develop the AdR System as a transit hub for passengers and freight
- ‘...continue to develop airport infrastructure...’
- ‘...continue an ongoing program of rationalization and restructuring with a view to achieving improved cost efficiency and service quality’
- ‘...fully exploit opportunities offered by major international events planned for Italy....’

The subsequent trade sales and secondary sales emphasized the need through the sales process to strengthen the AdR organization. This was done by bringing into the shareholder group a ‘financial’ and an ‘operational’ partner.

#### **d) Economic and Other Regulation**

Prior to the 1997 IPO, the airport charges of AdR were regulated on the basis of annual approvals by the Ministry of Transport to charges proposals put forward by the concession company. Within the 1997 IPO prospectus, it was argued that airport fees for AdR would ‘benefit’ i.e. increase as a result of a new approach set out in the 1997 Finance Bill. In actual fact, a new approach to airport charges at Italian airports has been a long time in development – only at the beginning of 2010 has a system been implemented at certain Italian airports including Naples. A new system is not expected to be implemented at Rome until early 2011.

One reason for the issues has been the long-term problems with the national flag airline Alitalia. Concerns over its well-being have led to abrupt changes in policy to the detriment of secure investment in airports. These problems have been mitigated by the sale of Alitalia in 2008.

The system that has been implemented at Naples, and is likely to be implemented at Rome, is of a CPI-X type including the following features:

- Based on building block costs – e.g. operating costs and return of and on capital;
- Four year approval periods;
- Based on the costs of the aviation till less 50% of the margin (in this case defined as returns after all costs including the cost of capital) arising from commercial activities; and
- A specific term for new infrastructure.

It is likely that the approach, when implemented at the Rome airports, will give rise to increases in charges levels.

#### **e) Lessons Learned**

AdR has undergone several changes of ownership within a thirteen year period in private ownership. It is not clear that private ownership has in many areas led to benefits to airlines or passengers. There has been little investment in infrastructure over the period. Traffic levels have not substantially improved. Senior management teams have been frequently replaced. Key lessons learned include:

- The failure to establish a system of regulation has resulted in static or falling airport charges in real terms (airport charges at Italian airports are among the lowest in Europe). This has resulted in the absence of a framework within which infrastructure development can be adequately remunerated. Not only has this deterred investment in airports themselves but it has raised investor concerns about the potential problems associated with wider investment in infrastructure; and
- The perennial economic and financial issues facing Alitalia, the national flag carrier of Italy, have negatively affected the airport and been a contributing factor to the failure to establish an appropriate regulatory regime for AdR.

#### **Relevance to Privatizations in a U.S. Context**

These lessons are likely to be of reduced importance in U.S. privatizations since the role of formal external regulation is more limited.

## St. Petersburg Airport a) Transaction Summary

Item	Description
Airport	Pulkovo, St. Petersburg.
Operational details	<b>2009 passengers:</b> 7 million. <b>Principal airlines:</b> Rossiya Airlines. <b>Configuration:</b> Two parallel runways, two terminals.
Type of privatization transaction	Trade sale. Concession.
Interest	100%.
Date of transaction	October 2009.
Valuation	<b>Transaction value:</b> €1.2 billion (approx. US\$1.8 billion). <b>Implied Enterprise Value:</b> n.a. <b>EBITDA multiple:</b> n.a.
Context	<ul style="list-style-type: none"> <li>• Only airport of St. Petersburg, Russia.</li> <li>• Operating company established in 2005 when the airline and airport in St. Petersburg were split into two entities.</li> </ul>

## b) Transactional and Governance Structure

The tender process for the Pulkovo PPP ran from April 2008 to May 2009. The bidding process was an onerous one with parties required to provide detailed capital expenditure and business plans, and to undertake substantial capital expenditure. There were initially nine interested parties, seven of which made it through pre-qualification but only three of which submitted final offers. The Northern Capital Gateway Consortium was announced as the preferred bidder on 25 June 2009, signing the PPP agreement with the City of St. Petersburg on 30 October 2009.

The concession requires the operator to provide €1.2bn worth of investment between 2010 and 2013 to improve the existing facilities. The most significant component of this will be spent on constructing the new terminal. Investment work at the airport is expected to commence in June 2010.

The European Bank of Reconstruction & Development (EBRD) has since agreed to provide a €100 million loan facility to the Project Company to assist in funding the planned works. The World Bank's International Finance Corporation (IFC) is also proposing to provide funds for the project, pending board approval.

Prior to the completion of the selection process, VEB, the Russian state bank, had agreed to provide a ten billion ruble ten year loan to the winning consortia.

The final three consortia which participated in the bidding were:

1. Flughafen Wien, Lider and Gazprombank;
2. Basic Element (Russian) and Changi Airport International; and
3. Northern Capital Gateway Consortium, consisting of VTB Capital, a UK based subsidiary of the Russian Bank (57.5%), Fraport AG (35.5%) and Copelouzos, a Greek investment group (7%).

### **c) Political and Regulatory Environment and Objectives of the Privatization**

The City of St. Petersburg linked private involvement with a demanding investment program designed to upgrade the airport significantly. Under the terms of the 30 year concession agreement, the Project Company is required to expand, finance and operate the facilities at Pulkovo Airport, including the construction of a new terminal and the provision of significant investment in both airfield and landside infrastructure.

The City had previously hired HOCHTIEF AirPort (HTA) to prepare a master plan and based on these findings Grimshaw & Partners Ltd, a UK based architecture firm, prepared a design for a new passenger terminal.

As well as seeking funds for upgrading infrastructure, the City of St. Petersburg also wanted to attract the services of an experienced airport operator to enhance the operations and service at the Airport.

The project fell under the jurisdiction of the City's PPP law introduced on 20 December 2006 (Law No.627-100 "On Participation of St. Petersburg in Public-Private Partnerships"). This project is one of the first PPP projects in Russia and has been regarded as an example to St. Petersburg and Russia of how a transparent PPP process can be implemented.

### **d) Economic and Other Regulation**

Economic and other regulation was one of the key areas of concern during the bid process. The existing system is based on an annual approval approach with airport operators submitting applications for changes to charges, no more than once a year, to the Federal Service on Tariffs of the Russian Federation (FST). The FST takes into account several factors including operating costs and current market conditions in making its decision. This process had the potential to lead to uncertainty and lack of transparency with charges changing from one year to the next and no clear principles being applied. It was not clear what the likely regime for regulation of airport charges would be in the future.

### **e) Lessons Learned**

The privatization of Pulkovo Airport attracted a lot of initial interest from international investors in spite of the economic downturn and the significant investment requirements between 2010 and 2013. It may be significant that a number of loan facilities were already made available or being arranged prior to the completion of the privatization. A master plan was also made available to the successful bidder. Nevertheless despite these advantages, and despite the fact the privatization is now seen as an example within the region, the number of parties making final bids was limited. Key lessons learned include:

- Offering bidders certainty in some areas, such as financing or future plans for the airport, may make the investment opportunity more attractive, though the requirement to take part in an expensive and resource consuming bidding process may still deter a number of parties, reducing the choice of qualified bidders and potentially acting to the disadvantage of users as well as the seller;
- The lack of a clearly established and transparent regulatory system is likely to deter foreign investors as they may perceive themselves as lacking the degree of protection which local companies may be able to secure. This may reduce the choice of qualified bidders to the potential disadvantage of users ; and



- Even if a number of features of the privatization are unhelpful, a privatization may still be possible in the short term if the asset itself is attractive enough. However privatizations in such circumstances may be prone to long term problems.

### **Relevance to Privatizations in a U.S. Context**

The St. Petersburg privatization is another example of the difficulty in finding the right compromise between ensuring the presence of a well qualified bidders with attractive plans and producing a process which will generate a wide and competitive field from which to select the final buyer. As a result, the first and third of these lessons may well be relevant to some U.S. privatizations. The second lesson is likely to be of lesser importance given the lower role of external formal regulation.

## Sydney Airport

### a) Transaction Summary

Item	Description
Airport	Sydney Airport or Kingsford Smith Airport.
Operational details	<b>2009 passengers:</b> 33 million. <b>Principal airlines:</b> Qantas, Virgin Blue, Jetstar, Tiger Airways. <b>Configuration:</b> Three runways (two parallel), three terminals.
Type of privatization transaction	Trade sale. Concession.
Interest	100%
Date of transaction	June 2002
Valuation	<b>Transaction value:</b> A\$5.6 billion (approx. US\$3.2 billion). <b>Implied Enterprise Value:</b> A\$5.6 billion (approx. US\$3.2 billion). <b>EBITDA multiple:</b> 14.3x (based on 2002/03 EBITDA)
Context	<ul style="list-style-type: none"> <li>• Australia's largest airport</li> <li>• Last privatization in a long process of corporatizing and privatizing the Australian airports.</li> </ul>

### b) Transactional and Governance Structure

In the 1980s, a Government Business Enterprise – the Federal Airports Corporation (or FAC) was created for the ownership and operation of 23 Australian airports, including Sydney Airport. This entity was allowed to earn a fair and reasonable return on investment for the Government. In 1996, two Acts were introduced to facilitate the privatization of these airports. The Airports Transitional Act was of particular importance, as it facilitated the lease of these airports to private sector operators.

The privatization of airports in Australia was divided into three phases. The sale of Sydney Airport to the Southern Cross consortium followed the successful sale of Phase 1 airports (Melbourne, Brisbane and Perth) and Phase 2 airports (a further 14 Commonwealth owned airports). After the sale of Sydney Airport, the privatization program was completed with the sale of the remaining three airports in the Sydney region

In March 2001, the Government announced its intention to dispose of its 100% interest in the main Sydney Airport by means of a trade sale process. The process was deferred, however, as a result of the disruptions to the aviation sector and to financial markets caused by the events of 11 September 2001. The process was resumed in March 2002, and the sale to the Southern Cross consortium was announced in June 2002.

The Southern Cross consortium was led by Macquarie Airports (40% interest). Other consortium members included the Macquarie Airports Group (12% interest), Ferrovial (20% interest) and Hochtief (15% interest). The Government did not publicly announce the number and identity of competing bidders for Sydney Airport. At the time of the privatization, press rumors suggested that there were two other bidders for the airport.

An important condition of the sale of Sydney Airport was that the Southern Cross consortium was given the first right of refusal, with a duration of 30 years, to build and operate any second major airport within 100 kilometers of the Sydney Airport.

### c) Political and Regulatory Environment and Objectives of the Privatization

The Government's objectives for the privatization of Sydney Airport were publicly announced as part of the sale process:

- Optimize sale proceeds within the context of the broader Government sales and policy objectives.
- Minimize the Commonwealth's exposure to residual risks and liabilities.
- Ensure that the airport lessees have the necessary financial and managerial capabilities to operate and provide timely investment in environmentally appropriate aviation infrastructure at Sydney (Kingsford Smith) Airport.
- Ensure the sale outcome is consistent with relevant airport legislative, regulatory and policy requirements, including environmental, foreign investment, competition, access and pricing policies.
- Ensure fair and equitable treatment of employees of Sydney Airports Corporation Limited including the preservation of accrued entitlements.
- Ensure the airport lessees demonstrate a commitment to the effective development of airport services, consistent with Australia's international obligations.

#### **d) Economic and Other Regulation**

In the period from 1996 to 2002, all major Australian airports with the exception of Sydney Airport (which was Government-owned at the time and subject to significant re-development) had been subject to price cap regulation.

In 2001 the charges at Sydney were subject to a separate review by ACCC which led to a full dual till cost based system being introduced. The combination of the cost based approach with the major investments at Sydney to prepare the airport for the Olympics led to an increase in charges of close to 100%. It was intended that prices would remain at this level for 5 years. In 2002, following a review by the Productivity Commission the Government announced that it would remove price caps for the airports, in a light-handed approach under which prices and service levels would instead be monitored by ACCC. This approach was also applied to Sydney Airport, which was privatized in that year.

Under this system the airports have in practice adopted a form of shadow regulation, in which prices are agreed with airlines based on a dual till costs approached in a similar manner to that applied by the ACCC to Sydney. An issue which led to continuing debate was the revaluation of assets, which airports believed had led to unjustified opportunities for price hikes.

In 2007 after a second review of the operation of the privatized airports, the Government announced its intention to continue the monitoring approach to charges at Sydney and other Australian for a further six years when another Productivity Commission review would take place. It also resolved the revaluation issue by setting a retrospective 'line in the sand' after which no further revaluations would be accepted for monitoring purposes.

Recently the Government has announced that there were concerns over the service provided at Sydney Airport and that it intends to bring forward this review for Sydney to 2011.

#### **e) Lessons Learned**

Sydney Airport was part of the final phase of airport privatization in Australia. The process was run with a clear set of objectives from the Government, which included maximizing sale proceeds

through a trade sale process. The fact that a 100% interest was for sale is likely to have helped the Australian Government achieve this objective, although it should be noted that there was, and continues to be, a limit on foreign ownership of Sydney Airport. The regulation of Sydney Airport has taken the form of light-handed price monitoring by ACCC with periodic major reviews by the Productivity Commission. Under this approach airports have negotiated cost based charges with airlines, under what has effectively been shadow regulation.

Recently, concern – based on reports produce by the ACCC in its monitoring role - that the service quality provided at Sydney Airport may not be optimal, has led the Australian Government to bring forward the next Productivity Commission review. One possible outcome of such a review might be an increase in service regulation in the future. It is potentially possible that more heavy-handed regulation may be introduced at least at Sydney. Key lessons learned:

- It is possible to sell a 100% interest in an airport while maintaining some control about the identify of future shareholders (i.e. the foreign ownership limit);
- Light-handed regulation under price monitoring can lead effectively to a system of shadow regulation in which cost based prices are set even without formal controls; and
- It is important that any monitoring process covers service as well as price so that any possible service problems can be identified and responded to.

#### **Relevance to Privatizations in a U.S. Context**

In Australia, unlike in the Europe privatizations at Copenhagen and BAA, the Government has been successful in applying limits to future share ownership. The first bullet point may well be of relevance in the U.S. although, care should be taken to ensure that any restrictions are watertight and achieve what is required of them. The more limited role of formal regulation in the U.S. means that both the second and third of these bullet points are less likely to be of importance in U.S. privatizations.

## Toronto – T3 privatization and the failed T1/T2 privatization

### a) Transaction Summary

Item	Description
Airport	Toronto Airport (Lester B Pearson Airport)
Operational details	3 terminals, 3 runways.
Type of privatization transaction	Trade sale. Lease. Partially failed.
Interest	100%
Date of transaction	1993
Valuation	<b>Transaction value:</b> n.a. <b>Implied Enterprise Value:</b> n.a. <b>EBITDA multiple:</b> n.a.
Context	<ul style="list-style-type: none"> <li>• Objective of the project was to redevelop Toronto airport with the involvement of the private sector through a public private partnership.</li> </ul>

### b) Transactional and Governance Structure

The Pearson International Airport project was a public private partnership with the objective of redeveloping Toronto airport with the involvement of the private sector. The project had two phases.

#### *Terminal 3*

This project was widely regarded as highly successful. From award of the contract in July 1987, the terminal was completed after 32 months although the project costs increased from \$350m to \$550m as a result of a forecast increase in the traffic levels of the terminal's principal tenant, Canadian airlines.

The winner of the T3 process was chosen following a two stage process. There was an initial request for expressions of interest and qualifications. A formal request for proposals was made at a second stage. Transport Canada stated that the objectives of the project were to provide a 'world-class' terminal in the shortest period of time; provide a financial return to the Crown; and maintain acceptable levels of safety and security to air travellers in Canada.

There were eight bidders at the first stage of the Terminal 3 process – mainly consisting of international consortia of operators, constructors and others. Five consortia qualified to proceed to the second stage of which four submitted a proposal. The winner, Airport Development Corporation was a privately held airport development organization which has subsequently been responsible for project in Hungary and Ecuador.

#### *Terminal 1/Terminal 2*

The T1/T2 process was much more problematic. The original process was constrained into a 90 (later extended to 125) day period between issue of the RFP and submission of binding bids. Following award of the contract to Paxport, the losing bidder ADC was asked to merge with the winners, as it was determined that Paxport lacked sufficient financial resources to manage the redevelopment program.

The merged consortium (renamed Pearson Development Corporation) signed a 57 year lease with the Government for the redevelopment and operation of the two terminals. There was intense media and political criticism of the deal focussed on alleged links between Consortium principals and the ruling Progressive Conservative party. A central plank of the Liberal party campaign in the

elections of 1993 was to propose the cancellation of award of the project. On gaining power, the Liberal Government requested a report on the transaction from Robert Nixon, a former Liberal provincial cabinet minister. His report found that the project ‘fell far short of maximizing the public interest’.

On December 3<sup>rd</sup> 1993, the contract was cancelled. There were attempts at negotiating a settlement. There was also an attempt to impose a financial settlement through statute which was not adopted by Parliament because of the resistance of the Progressive Conservative controlled senate.

Ultimately, a lengthy court case ensued (T1T2 Limited Partnership v Canada) over the level of compensation. Much of the court case focused on an appraisal of the likely level of future profits foregone by the Consortium as a result of cancellation. A key issue was the appropriate financial discount rate to apply to projections of earnings. The court case settled on a level of damages in significant excess of the damages that the Government attempted to impose by statute (C\$30m). It is also widely believed that a side deal was done in which T3 was purchased from ADC by Transport Canada for an amount in excess of its market value in order for the airport (now restructured as a not for profit entity, the Greater Toronto Airport Authority) to complete the redevelopment of the airport under public sector terms.

Subsequent to the termination of the privatization, the redevelopment of terminals 1 and 2 is complete though the new terminal has been heavily criticized by some airlines for being an over-expensive and leading to high charges. Some support for this is provided by the fact that Toronto’s charges are the highest in the sample of international charges in LeighFisher’s annual ‘Review of Airport Charges’ by a significant margin.

### **c) Political and Regulatory Environment and Objectives of the Privatization**

The objectives of the Terminal 3 privatization were specified by Transport Canada as follows:

- Provide a world-class air terminal facility
- Reduce government investment in airport facilities
- Increase private sector participation
- Provide a financial return to the federal government

The stated objectives of the T1/T2 privatization were broadly similar to those for T3.

### **d) Economic and Other Regulation**

Pricing, service standard and other regulations were largely determined within the 57 year lease agreed between the Pearson Development Corporation and the Government. These included:

- Sliding scale lease payments.
- The Government was prevented from undertaking actions which could devalue the operator’s franchise such as permitting an airport to be built within 25 kilometres of the airport if it would reduce passenger volume by more than 1.5 million passengers a year.
- Limitations were placed on retail and car parking prices that could be charged.

Further agreements were executed between Pearson and the major airlines – Air Canada and Canadian Airlines, inter alia specifying rental levels and performance standards.

As discussed above, the Nixon report found that Government sanctions on non performance by PDC were underspecified.

#### **e) Lessons Learned**

While the cancellation of the privatization may have been in some senses justified, it is also true that renegeing on the original terms under which privatization took place would have sent strongly negative signals to investors that investment in infrastructure in Canada was potentially subject to expropriation with no guarantee that the original investment would be remunerated. There are a number of lessons learnt, which are also reflected in the Nixon report into the privatization of Terminals 1 and 2:

- The abbreviated timetable for the process significantly favoured the ability of one party to put forward a winning bid since this party was already operating T3 reducing effective choice to the potential disadvantage of users as well as the sellers;
- The contracts were perceived as containing significant shortcomings, including what was later regarded as an excessive term for the lease in the Canadian context (57 years); and
- The performance obligations appear to have been phrased too broadly, making it difficult for the Government to know when conditions had been breached, and to take appropriate action.

#### **Relevance to Privatizations in a U.S. Context**

The conditions surrounding the T1/T2 sale in Toronto were highly specific - as were the related problems. The general lessons in points one and three may nevertheless be relevant to certain U.S. privatizations. The second point appears less relevant: significantly longer concession lengths have been offered for airports in other countries such as Australia, and indeed airports have been sold freehold, without apparent problems.

## Vienna Airport

### a) Transaction Summary

Item	Description
Airport	Vienna Airport / Flughafen Wien
Operational details	<b>2009 passengers:</b> 18 million. <b>Principal airlines:</b> Austrian Airlines (Lufthansa), Niki <b>Configuration:</b> Two runways, three terminals.
Type of privatization transaction	IPO. Freehold sale.
Interest	Initially 27%.
Date of transaction	1992, 1995 and 2001.
Valuation	<b>Transaction value:</b> n.a. <b>Implied Enterprise Value:</b> n.a. <b>EBITDA multiple:</b> 8.4x.
Context	<ul style="list-style-type: none"> <li>• Vienna was one of the first airports in Europe to be privatized, after the UK.</li> <li>• The privatization took place in several stages, with an IPO in 1992.</li> </ul>

### b) Transactional and Governance Structure

The partial privatization of Vienna Airport took place in several phases. Prior to 1992, the shareholders of Vienna Airport were the City of Vienna (50%), the Province of Lower Austria (25%) and the Federal Republic of Austria (25%). After the IPO in 1992, 27% of the airport was listed, and the interests of the original shareholders were reduced as follows: the City of Vienna (37%), the Province of Lower Austria (18%) and the Federal Republic of Austria (18%). After the secondary offering in 1995, 48% of the airport was listed and 1% was owned by Schiphol Airport. Original shareholders now held 17% each. Further changes occurred in the period up to 2001, when the Federal Republic of Austria ceased to be a shareholder. Currently, 50% of shares are listed, the City of Vienna and the Province of Lower Austria own 20% each, and an employee foundation owns the remaining 10%.

In anticipation of the public floatation, the corporate status of Vienna Airport had to be changed from a limited liability company to a joint stock company. The share capital had to be increased by 50%.

### c) Political and Regulatory Environment and Objectives of the Privatization

The objective of the public floatation of an interest in Vienna Airport was principally to raise funds for capacity expansion. The owners of Vienna Airport wanted to expand the airport's capacity from 6 to 12 million, but did not have access to the funds required to achieve this. The first phase of the public floatation was very popular with investors and many times oversubscribed. In 1995, a secondary offering was completed raising. This time, the funds were retained by the Austrian Government.

### d) Economic and Other Regulation

Aeronautical charges at Vienna Airport are regulated according to an approach, which sets individual formulas for landing, passenger and ground handling (carried out by the airport).

These formulas are calculated by multiplying volume growth by -0.35, and adding inflation. This means that charges increase more rapidly (or decrease more slowly) in the case of low volume



growth, effectively protecting the airport from volume risk to some extent. The ground handling formula also contains an adjustment for aircraft size.

The formulas were reviewed during 2006, coinciding with the opening of the new terminal building, and were renewed unchanged until the end of 2009.

#### **e) Lessons Learned**

The IPO of Vienna Airport was considered to be very successful, and the different stages of this privatization raised funds both for the airport itself and for the Austrian Government. However, it has often been suggested that there remains significant potential for achieving efficiency savings at Vienna Airport, and it may be the case that the current regulatory regime does not provide sufficient incentives for such savings to be realized. Key lessons therefore include:

- A simple progressive IPO process can be used to create a simple and popular privatization. This may not necessarily maximize the ultimate returns secured;
- Even after privatization it may be that the airport is not maximizing the efficiency of its operations, particularly if the widely dispersed shareholdings of an IPO mean that relatively little direct pressure is put on management to perform. This may be to the long term disadvantage of airport users
- If improving the efficiency of an airport, and as a result reducing charges, is one of the objectives of a privatization, it is important that appropriate incentives are put in place through economic regulation.

#### **Relevance to Privatizations in a U.S. Context**

The sale of Vienna Airport, like that of Brussels, was a relatively straightforward one in a European context. To the extent that an IPO is being considered, the first two of these lessons may well be relevant to some U.S. privatizations. The last is less likely to be relevant given the more limited role of formal regulation at U.S. airports.

## **Appendix D**

### **Non-Airport Privatization in the U.S. Transport Sector**

#### **D.1 Objective of Appendix**

The purpose of this appendix is to identify and document lessons learned from non-airport privatization in the transportation sector in the United States and the potential relevance to airport privatization.

#### **D.2 Introduction**

State and local authorities in the U.S. are increasingly considering public-private partnerships (“PPP” or “P3”) and other forms of privatization for transportation infrastructure. The federal government through congressional statutes continues to encourage this process through new and innovative programs, including the Private Activity Bonds (“PAB”) program, the Transportation Infrastructure Finance and Innovation Act of 1998 (“TIFIA”) program (as described in Appendix D.1), Interstate Tolling programs, the SEP-15 program,<sup>1</sup> the Corridors of the Future Program, and the Federal Transit Administration’s (“FTA”) PPP Pilot Program.

#### **D.3 Analytical Framework for Reviewing Transactions**

In non-airport transportation modes, the privatization model has been most actively pursued, both in terms of size of deal and volume of deals, in the highways sector. Therefore, the majority of the cases reviewed are in the highway sector, however, cases involving transit, parking, and ports were also analyzed. Transaction summaries were prepared for 19 deals encompassing these modes.

As many of the best lessons can be learned from failures rather than successes, it was important to review both deals that have and have not closed. In this context, it is important to note:

- Ultimately, ‘value for money’ can only truly be assessed at the end of a contract period. For example, the recent peaks and troughs in the economic cycle underscore that what might appear to be a good investment one year can rapidly appear to be an unwise investment the next. Further, as many of the transactions reviewed are large infrastructure projects with long design lives, a true appreciation of value for money will only be gained much closer to the end of those periods.
- Privatization is fundamentally underpinned by the concept of risk transfer (or risk sharing) between the public and private sectors. Inevitably, risks will be passed to the private sector at a premium on some deals, and these risks will not be realized. As such, it could be argued that in these cases ‘value for money’ was not achieved. Conversely, some potential risks will arise on other projects, and the premium placed on the risk by the private sector will prove inadequate, leading to private sector losses. As a result, true ‘value for money’ can only really be gauged by looking at the process as a whole, rather than on a transaction by transaction basis. The track record of privatization in the transportation sector in the U.S. is still too small and too recent to do this.

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<sup>1</sup> SEP-15 is a new experimental process for the Federal Highway Administration (FHWA) to identify new public-private partnership approaches to project delivery.

Given these constraints, it was necessary to posit lessons learned by comparing a number of similar transactions and contrasting their various outcomes to date. The non-airport transportation deals reviewed were grouped into discrete categories and identified as either representing “full privatization” where the full control and/or operation of an entire airport are vested with a private entity (via a long-term lease or sale of entire asset) or “partial privatization” where partial control and full ownership of an airport remains vested with the public owner as follows:

Mode	Type of Deal	Transaction	Form of Privatization
Highway	Long term revenue securitization on mature toll roads	<ul style="list-style-type: none"> <li>▪ Chicago Skyway</li> <li>▪ Indiana Toll Road (I-90)</li> <li>▪ Pennsylvania Turnpike</li> <li>▪ Alligator Alley, Florida</li> </ul>	<ul style="list-style-type: none"> <li>▪ Full</li> <li>▪ Full</li> <li>▪ Full</li> <li>▪ Full</li> </ul>
	Transfer of distressed start-up toll roads to the private sector	<ul style="list-style-type: none"> <li>▪ Pocahontas Parkway, Virginia</li> <li>▪ Northwest Parkway, Denver</li> </ul>	<ul style="list-style-type: none"> <li>▪ Full</li> <li>▪ Full</li> </ul>
	New private sector toll roads and managed lanes	<ul style="list-style-type: none"> <li>▪ South Bay Expressway (SBX), San Diego County</li> <li>▪ Dulles Greenway, Virginia</li> </ul>	<ul style="list-style-type: none"> <li>▪ Full</li> <li>▪ Full</li> </ul>
	Managed lane and availability payment projects	<ul style="list-style-type: none"> <li>▪ Texas IH-635 / LBJ Freeway</li> <li>▪ Miami Port Tunnel</li> </ul>	<ul style="list-style-type: none"> <li>▪ Full</li> <li>▪ Full</li> </ul>
	Development agreements and unsolicited proposals	<ul style="list-style-type: none"> <li>▪ TTC I-69 in Texas</li> <li>▪ I75/I575 in Atlanta</li> </ul>	<ul style="list-style-type: none"> <li>▪ Full</li> <li>▪ Full</li> </ul>
Parking	Off-street parking	<ul style="list-style-type: none"> <li>▪ Chicago garages</li> </ul>	<ul style="list-style-type: none"> <li>▪ Full</li> </ul>
	On-street parking	<ul style="list-style-type: none"> <li>▪ Chicago metered spaces</li> </ul>	<ul style="list-style-type: none"> <li>▪ Full</li> </ul>
Transit	Greenfield transit project	<ul style="list-style-type: none"> <li>▪ Las Vegas Monorail</li> </ul>	<ul style="list-style-type: none"> <li>▪ Full</li> </ul>
	Operating franchise for existing rail system	<ul style="list-style-type: none"> <li>▪ Boston Rail Operating Franchise</li> </ul>	<ul style="list-style-type: none"> <li>▪ Partial</li> </ul>
	Infrastructure and track maintenance (but not operations)	<ul style="list-style-type: none"> <li>▪ Denver FasTracks</li> </ul>	<ul style="list-style-type: none"> <li>▪ Partial</li> </ul>
Ports	Expansion and operation of marine terminal	<ul style="list-style-type: none"> <li>▪ Seagirt Terminal, Baltimore</li> </ul>	<ul style="list-style-type: none"> <li>▪ Partial</li> </ul>
	Upgrade and operation of container berths	<ul style="list-style-type: none"> <li>▪ Port of Oakland Outer Harbor</li> </ul>	<ul style="list-style-type: none"> <li>▪ Partial</li> </ul>

Most of these examples entail long-term concessions or leases of the entire asset (i.e., “full privatization”). It should be noted that some non-airport transportation assets also have forms of partial privatization as well. For example, the New Jersey Turnpike and Garden State Parkway, announced plans in October 2010 to seek bids from private operators to outsource the collection of highway tolls. In addition, many of the terminals and other infrastructure at U.S. ports were financed and developed by private cargo and cruise companies under long-term leases similar to privately financed unit terminals at U.S. airports (e.g., JFK, Los Angeles).

Appendix D.3 provides a summary of the key project details for each of the transactions, including the ownership, operational details, type of privatization, date of transaction, valuation, description of transaction, and other features.

Finally, it should be noted that when reading this appendix, the “valuations” of projects have come from a wide range of sources and wide range of circumstances and as a result they are not

directly comparable, but have been provided to give an indicative guide to the scale of the deal, rather than any precise project valuation.

## **D.4 Overall Conclusions and Lessons Learned**

Although each project is unique, there are a number of consistent themes from non-airport privatization that have relevance to airport transactions, including:

1. The success of these deals (ranging from 30 to 99 years) cannot be determined in the short term. Also, the length of a concession needs to be considered carefully. In particular, longer terms raise more upfront money, but do not necessarily deliver overall best value for money. This principle applies as much to airport owners, who have also been considering 99 year deals, as to any other privatization deal. To date the term of long-term leases or concessions for “brownfield” surface transport assets has been driven, at least in part, by accounting treatment and tax exposure, and the same rules apply to airports where the useful life of existing terminals can be 30-40 years. This suggests a 50-year term should be adequate for depreciation treatment on airport deals, and depending on the age of the airport, possibly less. In the case of the Chicago Skyway, the bridge had major components with a long useful life of 75+ years, which led to the 99 year term and the city of Chicago seemed comfortable carrying the 99-year term over to Midway to maximize the upfront payment but this term does not appear to have been driven by tax or accounting considerations. However, while a longer term does raise more upfront money, it should be remembered that it does not necessarily deliver overall best value for money.
2. Although funding constraints may be a key factor in moving a public sector body to consider privatization, value for money must be the main rationale. For example, the adoption of “63-20 financing”<sup>2</sup> may have appeared to offer a low cost funding solution, but the resultant misalignment of risk and reward did not always deliver value for money. Further, award criteria should not simply focus on price and, as value for money in its widest sense should be the objective, the inclusion of other considerations, such as environmental benefits, is both possible and beneficial. For airports, the consideration of wider economic and environmental benefits, and their inclusion within award criteria, is highly relevant.
3. Similarly, in measuring the success of a transaction, while the amount of the money received is an important consideration, it should not be the only criteria. It is also important to consider the investments made by the private entity in infrastructure, the level of service provided, the pricing of services to the public, the degree of environmental stewardship, and employee satisfaction. Airports, like all transportation infrastructure, do not operate in isolation, and have the same duties of care to stakeholders as other businesses. As such they must learn to balance simple monetary gains against these other wider considerations when considering privatization options.

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<sup>2</sup> 63-20 financing refers to the issuance of tax-exempt bonds by nonprofit entities to finance tangible public assets pursuant to IRS revenue ruling 63-20 of 1963, typically under long-term leases. For example, the 63-20 financing structure has been used to build hospitals, toll roads/bridges, university buildings, city halls, water and sewage facilities, hotels, and convention centers.

4. The letting of concessions delivers a stable financial environment to address maintenance needs of economically critical infrastructure, and this appears to remain true even if the project finances fail. Indeed, many have argued that, even when projects failed financially, it should always be remembered that much needed essential economic infrastructure was delivered when it was needed, and often decades ahead of when it would have been delivered using traditional funding approaches. However, to ensure full public support, the public sponsor also needs a clearly articulated plan for how any additional proceeds raised by the public sector are to be invested, especially when revenues are being raised from one sector (such as an airport) to finance another (such as highways or other social facilities).
5. The early years of a concession are the most vulnerable and the public sector has an important role to play in mitigating risk in these early years. The public sector must also appreciate the expectations of the market and deliver a transparent and timely procurement process. Valuing and then correctly allocating risk is central to delivering value for money for the public sector and, hopefully, ensuring a successful outcome for all the parties involved. In recent years, the aviation industry has experienced volatile market demand and conditions, usually as a consequence of events beyond the industry's control. Airport owners need to consider whether some form of revenue underwriting in the critical early years of a concession delivers better value for money.
6. Although underwriting private finance through direct user payments is one mechanism for delivering P3 projects, other mechanisms, including availability and performance payments, might represent a more appropriate risk transfer approach and deliver better value for money. Airports are the same as all the other schemes considered in this appendix in that there is the potential to transfer demand/revenue risk to the private sector. However, as we can see from recent highways and transit schemes, many are now questioning whether this risk transfer delivers true value for money and airports need to ask themselves the same question.
7. For strategic transportation projects, the role of the private sector is seen as one of delivery, not of definition or specification. A solicited approach to privatization procurements allows the public sponsor to maintain control of project identification (and therefore the overall strategy for the project and sector) while ensuring the private sector is focused on the areas where it can best deliver value for money, namely, delivery of the service required.
8. Although projects may appear to be similar, all have unique features, and these must be understood when developing the term and nature of the deal between the public and private sectors. Also, even the most technically complex project can be procured through privatization techniques. However, the involvement of the private sector cannot fundamentally change the nature of a project. For example, a project that needs a significant subsidy if procured by traditional means will still need a subsidy if procured as a privatization. In addition, even infrastructure of regional or national importance can, in principle, be procured through privatization techniques.

## **D.5 Long Term Revenue Securitization on Mature Toll Roads**

In this category of highway transactions, four similar assets are reviewed that have very different outcomes. The highest profile transactions in the transportation sector are the largest financially, in particular:

- Chicago Skyway – A 99 year lease for a payment of \$1.8 billion.
- Indiana Toll Road – A 75 year lease for a payment of \$3.8 billion.
- Pennsylvania Turnpike – A 75 year lease proposal that attracted a \$12.8 billion “best offer,” although this was ultimately withdrawn when the legislature failed to vote on the proposal.
- Alligator Alley – A 50 to 75 year lease proposal that had an extended bidding process, but which culminated in the Florida Department of Transportation receiving no compliant bids in May 2009.

All of these transactions involved existing tolled facilities and were offered as long-term concessions for the operation and maintenance of those existing facilities. However, the outcome for each was very different.

These projects were all promoted by their public sector owners for three basic reasons:

1. A desire to raise revenues immediately (to be used to pay off existing debts and to assist in the funding other planned new infrastructure).
2. A desire to create a stable financial environment that allowed the sustainable maintenance and operation of what were perceived to be critical elements of the regional transportation network.
3. The transfer of operating, maintenance, and revenue risk to the private sector to achieve overall value for money.

Although each of these transactions involved the transfer of the asset, the transfer of staff varied. For example, the Chicago Skyway contract required the concessionaire to offer jobs to the existing employees. However, because most employees were given the choice to keep their existing job most decided to stay with the city. In contrast, on the Indiana Toll Road, when the concessionaire took over, almost all of the managers from the public sector joined the concession company.

### **D.5.1 Chicago Skyway**

The Chicago Skyway reached financial close in October 2004 and was the first long term lease of an existing toll road in the U.S. The City of Chicago used \$1.8 billion received from the transaction to:

1. Pay down existing debt on the facility.
2. Fund a \$500 million long-term and \$375 million medium-term reserve for the city.
3. Fund a \$100 million neighborhood, human, and business infrastructure fund to be drawn down over five years.

In addition, as a result of this transaction, the city's credit rating was upgraded, which reduces its cost of future borrowing and therefore enables the city to deliver more projects. Therefore, the city achieved its first objective. It is also worth noting that the competitive process in this transaction delivered a winning bid that was 2.6 times more than the next nearest bid.

Regarding maintenance and operations, the Skyway concessionaire must follow detailed technical specifications based on "best practice." Apparently, under public control there were no such formal standards and hence the concessionaire is actually now required to uphold the road system to a higher standard than the city previously had. However, this does come at a price to users.

The concession agreement contains a pre-established toll schedule to 2017, and an agreement that after that date annual increases will be capped at the higher of 2%, consumer price index ("CPI"), or the increase in nominal gross domestic product ("GDP") per capita. By comparison, under the city's 47 years of control, toll changes were infrequent and on occasions actually decreased in real terms (such as the period from 1989 to 2004 where tolls declined by approximately 25% in real terms).

Some have contended that requiring the concessionaire to maintain the Skyway to a certain standard is inherently inflexible because at any point during the term of the concession this standard may be considered unnecessary or unaffordable. Despite this, it is clear that the letting of the concession has, at least to date, achieved the second objective of delivering a stable financial environment to address maintenance needs.

The risks inherent with the operation and maintenance of the Skyway, along with inherent uncertainties over future revenues, have been transferred to the private sector. However, it should also be noted that the deal does include a non-compete clause (which does reduce the usage risk to some degree) and there is no upside revenue sharing between the public and private sector.

Although it will be some time before it will become clear whether these risks have been transferred in a manner that delivers value for money, there are a number of recent events which provide some preliminary guidance on this issue.

- The original financial structure (backed by toll receipts) had equity at \$882 million and bank loans of \$948 million. In a subsequent refinancing, equity fell to \$510 million, with capital accretion bonds of \$961 million (21-year maturity; 5.6% interest rate), current interest bonds of \$439 million (12-year maturity), and subordinated bank debt of \$150 million. As the debt to equity ratio is, at least in part, a reflection of the perceived risk profile of a project by lenders, the refinancing to a higher debt to equity ratio generally implies a market perception of reduced risk. It is common for debt to equity ratios to change at refinancing as a project's risk profile inevitably changes over time. However, such a change does not mean risk was misunderstood at the time of the original deal.
- Many thought the price bid by the winning consortium was very high (as previously mentioned, 2.6 times higher than the nearest other bid). Then, as revenues continued to grow, it was suggested the original investors had achieved a good deal, as reflected in the refinancing. However, the recent economic downturn resulted in a decline of revenues, again raising concerns over the "high" original bid price.

The lesson is that the true value for money cannot be calculated until the end (or close to the end) of the concession, and that investments of this kind will, as with all businesses, go through good and bad times.

### **D.5.2 Indiana Toll Road**

From a chronological perspective the next transaction was the Indiana Toll Road. Like the Skyway:

- The monies were used to pay down existing toll road bonds and establish new transportation project funds, including a fully funded 10 year statewide “Major Moves” transportation plan. Similar to the Chicago Skyway deal, the credit rating of the state was upgraded, with consequent wider benefits.
- The concession also included maintenance and operational requirements to be met, and the concession can default if these standards are not met. An oversight board of state employees and private citizens reviews the concessionaires performance for non compliance with operational and maintenance standards. The concessionaire also made commitments to improve the toll road over the life of the concession, for example, by introducing electronic toll collection (an action that has already been implemented).
- The risk transfer profile offered significant private sector upside (including a non-compete clause and no revenue sharing).

This deal closed in 2006, and was a 75 year lease that raised an upfront payment of \$3.8 billion for the State of Indiana.

### **D.5.3 Pennsylvania Turnpike**

On the basis of the perceived successes of the Chicago Skyway and the Indiana Toll Road, there was an attempt to privatize the Pennsylvania Turnpike. Understanding this proposed privatization requires a review of the chronology of events in the period from 2006 to 2008.

In November 2006, Pennsylvania Governor Ed Rendell raised the idea of a long-term lease of the Turnpike to a private group as a means of raising money to improve infrastructure within the state. Then in December 2006, the state solicited information from firms interested in leasing the Turnpike. This action was motivated by the findings of a Transportation and Reform Commission, convened earlier in 2006 by the governor, which had concluded that Pennsylvania needed an additional \$1.7 billion of funding to maintain the current transportation system.

Although there appears to have been a general consensus that there was a major transportation funding deficit, leasing the Turnpike was not universally accepted as the solution. Concerns seem to have included the length of the concession, the application of P3 to brown-field rather than a green-field scheme, plus the prospect that the lease could go to a foreign company. As a consequence, two parallel funding initiatives were developed in early 2007:

- The Turnpike Commission proposed that they increase tolls on the Turnpike and introduce tolls on the untolled I-80. The Commission would then turn over funds to the Pennsylvania Department of Transportation (“PennDOT”) for statewide transportation



improvements, including transit. This was known as Act 44 and, assuming tolling of I-80 was approved, was projected to generate \$116 billion over 50 years.

- Meanwhile, around the same time, Governor Rendell released estimates of \$12 billion to \$16 billion to lease the Turnpike and asked the state legislature for permission to seek bids.

Given the difference in funds expected to be raised by the two plans, Act 44 was passed in July 2007 by the legislature and Governor Rendell agreed to halt the concession plans and support tolls on the I-80. In August 2007, the Turnpike also made its first payment of \$6.25 million to PennDOT as per Act 44.

However, although Act 44 was approved, it had exposed a number of geographical and philosophical differences within the legislature and the governor doubted that approval to toll I-80 would be given, which was a major element of the Act 44 funding plan. Therefore, in September 2007, Governor Rendell resurrected his plan to lease the Turnpike and in October 2007, 14 proposals to lease the Turnpike were submitted by the private sector.

Meanwhile, in the same month (October 2007), the Turnpike submitted an application to the Federal Highway Administration (“FHWA”) to toll I-80, and in December 2007, the FHWA asked for more information.

In February 2008, the governor announced his support for a bill that would repeal tolls on the I-80 and lease the Turnpike.

In May 2008, Abertis Infraestructuras, SA and Citi Infrastructure Investors submitted a \$12.8 billion proposal to lease the turnpike. This was the largest of the three bids received, but was still at the lower end of the values initially indicated by the governor in May 2007.

Under the terms of the offer, tolls could have been increased by the greater of 2.5% per year or by the change in the CPI, but the concessionaire would have to make a number of agreed upon improvements to the road and to maintain and operate it to defined standards.

Although both the private and public sectors had drawn heavily on the experiences of Chicago Skyway and Indiana Toll Road, there were a number of important differences between Pennsylvania Turnpike and the previous two deals. For example:

- There were concerns that the financial assumptions adopted by the public sector to estimate how much revenue they would have each year to invest were overly optimistic (the plan being to save most of the \$12.8 billion and use the annual interest to fund new projects).
- The state lacked a clearly articulated plan for how the proceeds were to be invested.
- The oversight mechanism for spending the funds was questioned, in particular the absence of legislative or public representation on the board that would be established to control investment decisions.

Meanwhile, the Turnpike Commission continued making payments under Act 44 (although it should be noted that these relied heavily on debt in the near term, with toll increases and the introduction of tolling on the I-80 being required to resolve its long term commitments under Act 44). Therefore, when the governor asked the legislature to approve the Abertis/Citi \$12.8 billion offer, several months of debate followed. Legislators were inundated with information from those both in support of, and against, the lease proposal. The three issues already listed above (financial assumptions, investment clarity, and the oversight mechanism) became the focus for much of the debate.

When the legislature failed to vote on the offer from Abertis/Citi in September 2008, the concessionaire let its offer expire (early October). At almost exactly the same time, the FHWA rejected the proposals to toll the I-80. As a result, the expected \$900 million a year in funding from Act 44 over the next 10 years was reduced to about half that value.

Although Pennsylvania adopted an approach very similar to that which had successfully delivered deals on the Chicago Skyway and Indiana Toll Road, it is clear that ultimately there were two fundamental problems:

- Although there was a commonly held understanding that there was a problem with funding transportation in the state, there was no consensus on the way forward.
- Although the process of public sector procurement was well run and the deal structure adopted a proven and robust approach, there was less clarity and transparency on how the public sector planned to use the funds they expected to receive.

It is also worth noting that the deal was progressing during the middle of 2008. Although the full extent of the oncoming recession and financial crisis was still not apparent to many until September 2008 (with the nationalization of Fannie Mae and Freddie Mac, Lehman Brothers filing for bankruptcy, Bank of America purchasing Merrill Lynch, and AIG receiving help from the Federal Reserve), there were already signs of stress in the market and as a consequence, the offer submitted by the private sector was at the lower end of expectations.

One can only speculate as to how the legislature might have responded had the offer been at or above the higher end of the range of values initially proposed by the governor (i.e., \$16 billion).

#### **D.5.4 Alligator Alley in Florida**

The Alligator Alley case study shows even more clearly how the downturn in the market 2008 (as well as the events surrounding the Pennsylvania Turnpike in the same year) influenced the market appetite for investing in long term toll road leases. The timetable of events for Alligator Alley was as follows:

- 1969 - The highway is constructed as a two-lane tollway connecting the two coasts of Florida. It was control accessed and tolls were based on toll revenue bonds issued in 1964.
- 1986 to 1992 – The highway was further widened to four lanes.

- 1999 – The toll plazas were converted to one-way tolling with the West Plaza collecting eastbound tolls and the East Plaza westbound tolls.
- 2007 – Revenues totaled approximately \$24 million a year and operating expenses were about \$6 million.
- May 2008 – An RFQ was issued by the Florida Department of Transportation (“FDOT”) followed by public workshops in Collier and Broward Counties.
- June 2008 – SOQ’s were submitted by 8 consortia, including investors that had been closely involved with Chicago Skyway and Indiana Toll Road.
- June 2008 – FDOT announced a plan to re-issue the Request for Qualifications (“RFQ”).
- July 2008 – Only 6 teams responded to the re-issued RFQ. Of interest, Macquarie (one of the main players in Chicago Skyway and Indiana Toll Road) did not submit a response this time, and neither did Abertis, (which had been one of the main players in the Penn Turnpike deal).
- August 2008 – All 6 groups who had responded to the revised RFQ were short-listed to bid.
- January 2009 – The bid deadline was extended to May 8.
- April 2009 – The bid deadline was further extended to May 18, however, one of the bid teams still formally announced it was abandoning its bid.
- May 2009 – A second bidder formally left the bid process and a number of team members moved between groups. Then on May 18, FDOT announced it had received no bids for the project and was therefore stopping the process.
- July 2009 – FDOT said it was not ruling out a P3 for Alligator Alley despite receiving no bids for the asset, stating it would continue to look at options for leasing. One official said "privatization is not off the table just temporarily dead because of the economy."

Later it was confirmed that ultimately only two groups were preparing bids for the asset by the time of the bid deadline (and interestingly neither included any of the entities involved in Chicago Skyway, Indiana Toll Road or Pennsylvania Turnpike). The two teams preparing to bid were a consortium of Vinci/Alinda and a Global Via/Atlantia pairing.

Clearly timing, both in terms of the recession/financial crisis, and following on from the failed Pennsylvania Turnpike, had a negative impact on the deal. Although Alligator Alley had a strong history of traffic and revenue growth, the recession in 2008 led to a 5.2% decrease in transactions and 6.7% decline in toll revenue, and over the bid period the economic outlook remained unclear.

However, some participants (and some who decided not to become involved) have suggested that a further problem was a lack of upside opportunity (and hence a lack of opportunity to make higher margins on the investment). At the time that the concession was being promoted by FDOT, toll rates on the Alligator Alley for cars were \$2.50 for cash customers and \$2.00 for

electronic/SunPass customers. The rate per mile was very low in comparison to other toll facilities across the country (78 miles at 3.2 cents per mile). The concession proposed a toll increase of 50% in 2009 to \$3.75 and \$3.00 for cash and electronic customers, respectively. After 2009, rates were to be permitted to be raised at the greater of either 3% per year or the rate of inflation (“the ratio of the Index for the immediately preceding Index year ended June 30th to the Index for the second most recent Index year ended June 30th”). This meant there was very little above inflation revenue growth opportunity in the deal.

Finally, unlike previous deals, FDOT included a revenue sharing clause, which further limited upside opportunities for the private bidder.

Although the market conditions in 2008 and 2009 undoubtedly influenced this transaction, it would be wrong to conclude this was the only reason for failure. It would appear that the market that had developed to bid for these revenue securitization deals was accustomed to greater risk (and hence greater potential returns) than that being offered in the Alligator Alley deal, and this further influenced those interested or willing to consider a bid for the project.

### **D.5.5 Lessons Learned from Long Term Revenue Securitization**

The success of a long term lease (50 to 99 years) cannot be determined in the short term. Further, even if the risks transferred to the private sector did not materialize, it does not mean that ‘value for money’ was not achieved by the public sector by the transfer of that risk to them.

In addition, the letting of long term concessions should deliver a stable financial environment to address maintenance needs of economically critical infrastructure. However, some argue that the inherent inflexibility of a long term lease is not a good thing, with the concession in effect making the commitment to maintain the asset to a certain standard despite the fact that such a standard may be considered unnecessary or unaffordable in the future.

The term of long-term leases or concessions for “brownfield” (i.e., existing asset) transactions is driven in part by tax treatment. If the lease is structured to have a term that exceeds the remaining life of the asset (e.g., road, parking, transit, port, or airport facility), the private operator can be considered the “owner” of the asset and the asset can be depreciated for tax purposes.<sup>3</sup> There is no specified percentage requirement beyond the useful life, but tax lawyers are more comfortable with some cushion. Depreciating the asset allows the private operator to reduce the amount of net income subject to taxation, which in turn provides the opportunity for a higher upfront lease payment. The same rules would apply to airport concessions where the useful life of terminals can be 30-40 years and the airfield less. Therefore, a 50-year term would be adequate for depreciation treatment, and depending on the age of the airport, possibly less. In the case of the Chicago Skyway, the bridge had major components with a long useful life of 75+ years, which led to the 99 year term. The city of Chicago seemed comfortable carrying the 99-year term over to Midway to maximize the upfront payment.

A bigger motivating factor seems to be that a longer term generates a larger upfront payment. This is especially relevant when there is substantial debt to be paid off to provide a large

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<sup>3</sup> Title 26 – Internal Revenue, Chapter 1, Internal Revenue Service, Department of the Treasury, Subchapter A – Income Tax, Part 1 – Income Taxes, 1.167(a) – 4 Leased property.

enough upfront payment to defease the debt and also provide a significant return to the public owner.

In the early toll road deals, the private operators were financing the transactions at very high leverage levels with long amortization periods (40 years). The rating agencies felt more comfortable with a cushion of years left in the concession after the anticipated bond amortization period. For example, in the Indiana toll road transaction, a 50-year term would have worked for tax purposes for the toll road lease, but the bidders' ability to secure more favorable financing was significantly enhanced by the 75-year term. This type of high leverage is no longer available, and therefore this is no longer a driving factor.

The other lessons learned from these experiences, with respect to considering “good practice” for P3 or Privatization deals is:

- The financial assumptions adopted by the public sector to estimate how much revenue they would have each year should be robust. The traditional approach in most countries is to develop a public sector comparable and this is now generally accepted as good practice for the public sector.
- To deliver full public support, the public sponsor should have a clearly articulated plan for how the proceeds are to be invested and, given the timescales involved, the oversight mechanism for spending the funds needs to be seen as transparent and nonpartisan.
- The public sector has to acknowledge the state of the market, the nature of the returns the market expects, and should aim for a transparent and timely procurement process.

## **D.6 Transfer of Distressed Start Up Toll Roads to the Private Sector**

The four previous examples focused on existing toll roads with a long track record of traffic, revenues, and costs. The next category relates to toll roads that were initially developed and funded by the public sector, but which upon opening, entered into financial difficulties and were then offered to the private sector as a way of resolving those difficulties. Therefore, this category focuses on lessons learned in the value of revenue risk transfer by the public sector.

### **D.6.1 Pocahontas Parkway**

Pocahontas Parkway (Route 895) is a 9 mile toll road in Richmond, Virginia. The 4-lane road connects Chippenham Parkway at the I-95 with I-295 south of the Richmond International Airport.

The initial key timeline of events were:

- 1995 -The Virginia General Assembly passes the Public-Private Transportation Act (“PPTA”) which allows private groups to raise money to build and operate transportation facilities. The aim is to generate transportation funding that otherwise would not be available.
- 1997 – The not-for-profit Pocahontas Parkway Association (“PPA”) is formed in response to a proposal by a private sector consortium of Flour Daniel/Morrison Knusden to build

the project as a toll road. PPA has the powers to issue bonds for constructing and operating Pocahontas 895. This is Virginia's first-ever PPTA project.

- 1998 – Construction begins.
- September 2002 – The Pocahontas Parkway, which cost \$314 million, opens to traffic.

The PPA was a particular form of corporation that is classified as a “63-20” by the Internal Revenue Service. Much of the risk was left with the PPA, and the contract included limited liability provisions if the corporation defaulted.

The Pocahontas Parkway was only the second transportation project nationwide to be financed through a 63-20 corporation. As we discuss later, this has not proved to be a successful approach to P3 deals.

Upon opening, it became clear that Pocahontas Parkway had been promoted on forecasts of traffic and revenue that were significantly over estimated. The Pocahontas Parkway had financial problems from the start and was in danger of defaulting on upcoming debt service payments in 2005. This was despite VDOT agreeing to defer its reimbursement of annual operating and maintenance costs associated with the toll road. To get a sense of the scale of the shortfall, the Virginia Department of Transportation (“VDOT”) said that in 2006 average daily traffic using the Pocahontas Parkway was only 60% of projected traffic in the original PPA business case.

In recognition of the Pocahontas Parkway’s difficulties, Transurban submitted an unsolicited proposal under the PPTA for the concession of the parkway. Transurban is a toll road operator from Australia (rather than a highway contractor).

As it became clear the Pocahontas Parkway would not be able to continue to meet its debt payments, VDOT chose to end its contract with Fluor Daniel/Morrison Knudsen and began negotiations with Transurban.

When VDOT was negotiating the deal with Transurban it should be remembered that there was a strong possibility that in the next few years the Pocahontas Parkway Association would have had insufficient toll revenues to fully cover the debt service on the toll revenue bonds. This could have led to default on some of the bond interest payments, and financial losses for the private bondholders, or could have led to the state subsidizing the amount of the interest payments that were in default.

In June 2006, after the completion of a competitive process as outlined by the PPTA, the VDOT and the Pocahontas Parkway Association agreed to a 99-year lease for Transurban to manage the Pocahontas Parkway.

Under the original VDOT-PPA agreement, the project value was \$318 million, with \$300 million financed privately through the issuance of bonds. When Transurban took over the Pocahontas Parkway in 2006, it entered into a 99-year lease agreement with VDOT for \$611 million. The funds from Transurban were used to defease all of the outstanding debts and covered a deferred reimbursement to VDOT for operation and maintenance costs incurred up to that date.

The new contract with Transurban included the establishment of toll levels and increases, which were capped at \$0.50 per year through 2010, and \$0.25 per year through 2016. If revenues exceeded expectations, a revenue sharing mechanism between Transurban and VDOT was triggered.

Transurban's contract stated that it was to take over all the cost and management of operations and maintenance of the Pocahontas Parkway, which included an upgrade to electronic tolling and the construction of an airport connector. The electronic tolling has since been introduced and the airport connector was under construction as of September 2010.

The original Pocahontas Parkway contracts included one for the total operation and maintenance of the facility and a second for the formation of a 63-20, although they varied in the placement of financial liabilities. As it became clear the first contract would fail because of the lower than anticipated traffic levels, it also became clear that the remaining debt would become a state obligation. In order to avoid a repetition of such a significant tax burden falling on Virginia residents in the future, VDOT's contract with Transurban included non-recourse financing to protect the state.

There are a number of lessons to be learned from the Pocahontas Parkway project:

- Although the original scheme involving PPA was promoted as a public private partnership, it is clear that the risk allocation was actually heavily biased towards the public sector. The potential benefits of raising tax exempt bonds using the 63-20 structure turned out to be outweighed by the basic commercial risk of the project.
- The later involvement of the private sector using non-recourse financing has not only removed a major potential tax burden from the citizens of Virginia, but has ensured the delivery of what is viewed to be an important new highway link to the airport.

In addition, the private sector accepted revenue sharing on the upside.

### **D.6.2 Denver North West Parkway**

The Denver North West Parkway is a toll road that connects E-470 in the east, at I-25, with U.S. 36 and State Highway 128 in Broomfield. This project was initially promoted and funded by a group formed by three city councils (Broomfield, Lafayette, and Weld County) and a property developer who used state laws created in the mid-1980s to create the "not for profit" Northwest Parkway Public Highway Authority. As a public private partnership with state-granted governmental powers, the new authority secured two important tools:

- The ability to condemn land
- The ability to sell tax-exempt revenue bonds

Construction of the Northwest Parkway commenced in June 2001, under a design/build contract by the Highway Authority. The Northwest Parkway opened to traffic in November 2003, and toll collection started on January 1, 2004.

However, like the Pocahontas Parkway, the Northwest Parkway consistently generated less income than envisioned when it was funded. The Northwest Parkway was originally built with \$416.4 million in bonds, to be paid back with toll revenue over 35 years. Due to the road's under-utilization, the bond debt was downgraded in 2006.

To get a sense of the scale of the short fall in traffic, in 2007 there were 12,000 cars per day, well below the 18,500 expected in 2004 (one year after opening).

As a consequence of these financial difficulties, the public sector decided to look into the potential for the private sector take on the project and the associated debt problem. At that time, the public sector identified its primary goals as:

- Maximize the value of the toll road
- Retire current debt
- Maintain or exceed current levels of service

The key timeline for the events that followed were:

- September 2006 - an RFQ was issued to private sector financial groups
- October 2006 - 11 bidders were short-listed
- April 2007 - Brisa/CCR was named preferred bidder
- November 2007 - Financial close reached
- January 2008 - Syndication launched for Northwest Parkway
- May 2009 - Brisa confirms acquisition of the remaining 10% from CCR, bringing its total equity stake in the Northwest Parkway to 100%

It is interesting to note that Brisa, like Transurban, is a toll road operator not a contractor. Although many participants focus on construction, a key aspect of privatization is the operational phase, which is far longer, and from both a financing and user perspective, far more important than the construction phase. This change in mindset to think of a project over its entire life cycle (i.e., construction, maintenance, refurbishment, etc.), and hence the delivery of a service, rather than a physical asset, is critical to delivering successful P3 projects.

The Brisa deal did have some funding problems:

- To achieve financial close, Brisa had to increase its equity commitment.
- The syndication process was also affected by the financial crisis, even though, ultimately, syndication was achieved.

These problems are now common to all P3 infrastructure deals, with larger equity contributions a common feature, as developers have found it harder to access the debt markets post credit crunch, as well as the loss of the debt syndication market.



However, this deal did confirm that under the right conditions P3 projects could still be financed even during the recent financial crisis.

### **D.6.3 Lessons Learned from Distressed Start up Toll Roads**

The first key lesson learned relates to valuing risk. As research has shown,<sup>4</sup> the biggest risk in traffic forecasting relates to the early traffic levels achieved on green field projects. It seems this risk may not have been fully appreciated or valued when the projects discussed above were developed.

The second key issue is an over emphasis on funding instead of the risk transfer and full-life 'value for money' considerations. Although both Pocahontas Parkway and Denver Northwest Parkway originally appeared to be private sector projects, the particular not-for-profit corporation (63-20 financing) adopted in both cases meant that ultimately the main risk for the project (i.e., traffic revenues) rested with the public sector not the private sector.

While a 63-20 financing does have certain tax benefits that make it attractive from a funding perspective, some argue that because the private party has no long term equity interest in the project to protect under a tax-exempt transaction, the motivation of the private sector to succeed, a key aspect of P3 or privatization deals, is lost.

## **D.7 New Private Sector Toll Roads**

This section reviews the group of toll road transactions that were promoted and financed by the private sector and highlights what has been a major issue for private sector toll roads, namely their vulnerability to failure and default in the early years of the concession life. The transactions reviewed show the problems that can arise and how they have traditionally responded.

The projects are:

- South Bay Expressway, San Diego County, California.
- Dulles Greenway, Virginia.

### **D.7.1 South Bay Expressway**

The South Bay Expressway is a 9 mile toll road (with a 3 mile connector) promoted by Caltrans. The project completed the missing link in San Diego's north-south freeway corridor.

The enabling legislation is California's AB 680 legislation passed in 1989 and funded by a TIFIA loan. Financial close occurred in May 2003, and the road opened to traffic in November 2007. The award followed a competitive design-build bid procurement process in which the same designer, design subcontract, and design price were mandated to each bidder.

The conditions of sale were that a limited partnership, South Bay Expressway, L.P., holds a franchise with the State of California under which it financed and built the highway, then transferred ownership to the state. The limited partnership then leases back, operates, and maintains the facility for 35 years. In 2042, control reverts back to the state at no cost.

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<sup>4</sup> Standard & Poor's, "Traffic Forecasting Risk Study Update 2005: Through Ramp-Up and Beyond," August 2005.

The northern 3 mile segment of the South Bay Expressway, including the SR 54 interchange, was financed using a mix of federal funds and local sales tax proceeds. Both sections were built by the same contractor under two separate design-build contracts. Funding sources for the Southern Toll Section were investor equity, bank debt (\$470 million), TIFIA loan (\$140 million), and donated right of way (\$48 million). The bank debt was syndicated to a group of 10 banks. For the Northern Connector section, federal funds were used (federal aid receipts) and local sales tax receipts.

The \$140 million 35-year TIFIA loan was the first-ever provided to a private toll road development. It was secured by a second priority security interest in all project revenues subordinate to the lien of the senior loans. The project revenues consist of (a) all income, tolls, revenues, rates, fees, charges, rentals, or other receipts derived by or related to the operation or ownership of the project, including all amounts from joint development or leasing of air space lease rights, (b) any revenues assigned to the borrower and proceeds of the sale or other disposition of all or any part of the project, and (c) all income derived from permitted investments.

The franchise allows a maximum 18.5% return on total investment with an additional incentive return for action to increase average vehicle occupancy on the toll road. However, unlike the Pocahontas or Denver North West Parkways, the risk that revenues would not meet expectations was fully transferred to the private sector..

In March 2010, South Bay Expressway, L.P. and California Transportation Ventures, Inc. filed petitions in the U.S. Bankruptcy Court for the Southern District of California seeking relief under Chapter 11 of the Bankruptcy Code. It cited lower than expected revenues as a consequence of the recession combined with larger than anticipated construction costs (in part related to land acquisition issues).

Although the investor lost its equity, the road remains open for traffic, with the road continuing to be operated by South Bay Expressway under Chapter 11. From the perspective of toll road users, nothing has changed. Some risk transfer projects result in profits and some result in losses for the investors.

As of September 2010, the precise scale of outstanding debt was unknown, but as revenues are expected to exceed operating costs (and a new equity investor is being sought), it is likely the debt will ultimately be repaid under a revised debt payment program. In fact, the next Dulles Greenway case provides some guidance on the most likely path to be followed by the South Bay Expressway.

### **D.7.2 The Dulles Greenway**

The Dulles Greenway is 14 miles long and runs from the public sector owned Dulles Toll Road (which is owned by the US Government but leased to the Washington Airports Authority) to Leesburg in Virginia. The two toll roads join at a single toll plaza where drivers pay one toll that is divided between the operators of the two facilities.

The Dulles Greenway toll road was privately financed and constructed over two years (1993-1995) as a Design Build Finance Operate (“DBFO”) highway. The initial agreement envisaged operational responsibilities reverting to the public sector in 2036. A 1988 action of Virginia's

General Assembly enabled the project to proceed by authorizing private development of toll roads. The maximum toll schedule through 2012 was set by the Virginia State Corporation Commission (“SCC”). For the period 2013 to 2020, tolls could be escalated at real GDP, CPI plus 1%, or 2.8% per year (whichever is greater). After 2020, tolls were to be set by the SCC on application. It was one of the first U.S. projects to exemplify the basic concept of project revenue financing.

The original financing of the Greenway (by the limited private partnership TRIP II) involved \$40 million in equity and approximately \$300 million in debt. Institutional investors provided \$258 million in long-term, fixed-rate notes that were due in 2022 and 2026. In addition, a number of commercial banks agreed to provide part of the construction funding and \$40 million in revolving credit. All the loans were to be serviced by revenues from tolls collected on the road.

In September 1995, the Greenway opened to traffic, but, like many of the examples already discussed, the actual traffic levels and associated total revenues fell well short of the levels forecast. In response to the traffic shortfall, toll rates were reduced. Although traffic increased in response to the reduction in rates, total revenues did not increase. Therefore, in July 1997, tolls were increased and the speed limit on the toll road was raised from 55 to 65 mph.

Because of the lower than anticipated revenues, the project began to default in 1996 and in 1999 a large refinancing package was approved that was expected to resolve the project’s financial problems. Despite the refinancing, the project continued to struggle financially and in 2001 the SCC extended TRIP II’s concession period for an additional 20 years to 2056.

In 2004, variable peak and discounted off-peak point-to-point toll rates were introduced on the Greenway to better manage peak period congestion, becoming the first toll road in the Washington D.C. region to have variable toll levels by time of day.

In September 2005, TRIP II was purchased from the original project developers by Macquarie Infrastructure Group (“MIG”) for \$617 million.

The opening years for the Greenway project were a challenge. The limited private partnership defaulted on its original long term financing from the very first debt service due date because traffic and revenue was extremely low. There was much debate at the time over why the traffic and revenue projections were so faulty, but it is generally believed that it came down to a combination of factors, including an unexpected upgrade of the competing parallel road and the slower than expected development of land along the route.

Nevertheless, the basic concept for the Greenway seems to have been sound. Loudoun County’s population grew from 86,100 in 1990 to 169,600 in 2000, representing a growth of 97%. Although there have been major disputes over development policy in county government, growth continues to be strong and the area is very attractive for development. Nearby Jefferson and Berkeley Counties, along with the airport, are also developing and also feed the Greenway. Although it would be wrong to attribute all of the project’s early failings to lack of development, it is clear that the rate of development in the corridor in the early years of the concession was over estimated. However, from the fourth year traffic grew strongly and the original bondholders were paid roughly \$0.90 on the dollar. It is also clear that 10 years after opening (and with 50 years of

concession life remaining) the project was an attractive high yield investment opportunity for MIG when they acquired it in 2005.

In Europe, where there is a longer track record of funding green field toll roads, a number of approaches have been adopted to address this “early year” traffic risk issue, such as the Loan Guarantee Instrument offered by the European Investment Bank as described in Appendix D.2.

The public sector has an important role to play in addressing early revenue risk in facilities such as toll roads if value for money is to be achieved using P3 structures.

### **D.7.3 Lessons Learned from New Private Toll Roads**

The lessons to be learned from these toll road transactions include:

- These projects are most vulnerable to failure in the first few years after completion.
- The public sector has an important role to play in mitigating this risk if maximum value for money is to be obtained.

Lessons are being learned and projects are now genuinely developing as public private partnerships under the TIFIA program. As each party takes on the risks it is best able to manage, value for money considerations take a more central role instead of simply maximizing upfront public sector financial receipts.

## **D.8 Managed Lane and Availability Payment Road Projects**

This section reviews the group of toll road transactions for new generation “Managed Lanes” and “Availability Payments.” These newer approaches to financing attempt to deal with the issues encountered by private sector toll roads as discussed earlier.

The projects are:

- Texas IH-635 / LBJ Freeway, Texas.
- Miami Port Tunnel, Florida

### **D.8.1 IH 635 / LBJ Freeway**

Texas has most actively adopted privatization structures for highways in recent years, and while the Texas House of Representatives voted in December 2007 for a two-year moratorium on any new agreements to private companies to collect tolls on new roads or to sell existing roads to tolling companies, this did not have an impact on the already substantial deals in the pipeline at that time. In addition, the moratorium excluded certain geographical areas.

The Texas Department of Transportation (“TxDOT”) is the promoter on the IH-635/LBJ Freeway. The project consists of improvements to the existing IH-635 (LBJ Freeway) in the Dallas-Fort Worth area and is part of a corridor that extends 21 miles from Luna Road to US 80. The IH-635/LBJ Freeway includes a portion of the IH-35E facility that extends south of IH-635 to the Loop 12/IH-35E Interchange. Construction is schedule to start in early 2011 and is expected to be complete in 2016.

This is a “managed lane” project. As the demand for travel by highway increases while investment in new highways remains low, there is a growing interest in maximizing the efficiency and operation of existing highway assets. This has given rise to the concept of managed lanes. As defined by the USDOT, Federal Highway Administration,<sup>5</sup> managed lanes consist of one or a combination of the following operational strategies:

- Pricing—Both traditional toll lanes and toll lanes that use congestion pricing, where price is varied during certain time periods in order to manage demand (e.g., peak-period surcharge or off-peak discount).
- Vehicle eligibility—The lanes are managed by allowing certain vehicles or restricting others; minimum occupancy is an example of an eligibility restriction.
- Access control—An example would be express lanes where all vehicles are allowed but access is limited during long stretches of the facility, minimizing turbulence in the flow of vehicles.

TxDOT has defined a managed lane as follows:

"A managed lane facility is one that increases freeway efficiency by packaging various operational and design actions. Lane management operations may be adjusted at any time to better match regional goals."

TxDOT developed a range of actions that are available for managed lanes based on three criteria:

- Time of Day Restrictions - allowing access to lanes at certain times of the day.
- Vehicle Type Restrictions - allowing access to only certain types of vehicles, such as carpools, buses, trucks, or vehicles paying a fee.
- Value Pricing - charging motorists for access to managed lanes and/or charging at varying rates for specific *time periods*

The IH-635/LBJ project provides an interesting example for the following reasons:

- The “value pricing” element of managed lanes (also known as congestion pricing or peak-period pricing) has become particularly attractive in Texas because it allows additional capacity to be added to highways and revenues raised to fund these improvements, while maintaining the position that existing highway capacity remains free of charge.
- By considering these different forms of traffic management (in particular, value pricing), managed lanes attempt to keep a roadway from becoming congested over time, and to optimize traffic to achieve the best vehicle and person throughput.

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<sup>5</sup> USDOT, Federal Highway Administration, *Managed Lanes: A Primer*.  
[http://ops.fhwa.dot.gov/publications/managelanes\\_primer/index.htm](http://ops.fhwa.dot.gov/publications/managelanes_primer/index.htm)

- Although the prioritization of road space to certain vehicle categories is not new (high occupancy vehicle or HOV lanes in North America and Bus Lanes in Europe have been around since the 1970s) what makes managed lanes new and different is the use of pricing as one of the key actions or techniques to influence lane use. Use of pricing to influence use of a limited number of highway lanes is a unique U.S. concept. Although both Europe and Asia use pricing as a means to manage road space, the concept is applied across whole networks rather than selected lanes. For example, the London Congestion Zone or the Singapore Road Pricing Cordon are a form of road pricing, but not just for certain lanes.

The concept of managed lanes should not be confused with the proposals in Oregon to introduce a user fee for roads. The Oregon proposal would effectively convert the existing system of taxing highways based on fuel consumption to a tax system based on distance travelled and roads used. The key distinction is the Oregon proposal is not designed to ration road space, but rather to allocate the cost of road maintenance more equitably.

Funding additional roadway capacity using managed lanes is growing in popularity with private finance programs being promoted in Texas, Virginia, and Georgia.

The process began with the submission of qualifications by four potential bidders in September 2005, but the financial close was significantly delayed, and was completed in June 2010. Although the project suffered in part from the 2008 financial crisis, the lack of political agreement in Texas over tolling and the consequent lowering of confidence in toll financed projects in the financial markets also delayed the progress.

The \$2.6 billion project is expected to be financed with \$600 million in private activity bonds (PABs), a TIFIA loan of \$850 million, a \$630 million equity contribution from the winning consortium, and \$520 million from TxDOT. The PABs will be senior debt secured on the project's revenue and the TIFIA loan will have subordinate status unless the project goes into bankruptcy, at which point the TIFIA loan moves up to parity with the senior bonds.

There are a number of interesting aspects to this transaction as follows:

- This is the first direct investment by a U.S. public sector pension fund in a private finance highway project. Large public sector pension funds (especially those based in Canada) are becoming increasingly involved in direct investment in P3 transportation projects. The equity potential of the pension fund market is very large. In addition, many see pension funds as an ideal equity investor in infrastructure investments such as toll roads because they have many features that are attractive to pension funds, including long tenures, inflation indexed revenues, cash generating attributes, and revenue stability.
- The role of the TIFIA funding in this deal was also important because it provided funding flexibility in the critical early years of the project and as such, it was a critical element in the overall funding package.

### **D.8.2 Miami Port Tunnel**

Because of the risk premium attributed to traffic and revenue risk for toll road projects by private bidders, some promoters have attempted to achieve better value for money by transferring some of

this risk back to the public sector. In addition, some projects do not lend themselves to the imposition of tolls. These factors have led to the concept of “availability payments” for P3 highway projects.

The Miami Port Tunnel project was promoted by Florida Department of Transportation (FDOT) in partnership with Miami-Dade County and the City of Miami. The design-build-finance-maintain-operate (DBFMO) contract proposed was for 30-years of operation after a maximum of 5 years for construction and improvements. The tunnel would connect Watson Island to the Port of Miami-Dade and is expected to remove many trucks and buses from downtown Miami streets.

The transaction was launched in February 2006 and in April 2006 three consortia were short-listed. All three teams submitted bids in March 2007. The bidders were:

- FCC Construcción/ Morgan Stanley (FCC Construcción/ Morgan Stanley/ Hatch Mott MacDonald/ Edwards & Kelcey).
- Miami Access Tunnel (Bouygues/ Babcock & Brown/ Transfield Services).
- Miami Mobility Group (ACS Infrastructure Development- Dragados USA/ Odebrecht/ Parsons Transportation/ DMJM Harris/ Iridium).

In May 2007, the Miami Access Tunnel consortium was chosen as preferred proponent. Of all the contending consortia, this group had proposed the lowest annual maximum availability payment at \$33.23 million.

However, the project struggled to reach financial close during the credit crunch so FDOT cancelled the project in December 2008. Subsequently, in April 2009, FDOT unexpectedly reaffirmed its commitment to the deal by agreeing to move forward with the existing procurement process. They said they would move forward again with the Miami Access Tunnel consortium, although the new procurement timetable required the deal to reach commercial close by June with financial close to follow on October. FDOT also said that in the event that this timetable was not followed they would re-tender the project.

The commercial close occurred in June 2009 and financial close in October 2009. The participation of the TIFIA credit office appears to have been a critical factor in the project moving forward. The TIFIA debt is approximately \$340 million with a 35-year term loan and a fixed interest rate of 4.31%. The equity consortium, comprised of Meridiam Infrastructure at 90% equity and Bouygues at 10% equity, provided \$80 million. A total of ten banks provided \$340 million of senior debt which pays margins of 300 basis points.

The gearing ratio is 90:10,<sup>6</sup> which is relatively high for a toll road, but reflects the market’s different perception of risk on an availability payment project versus a traditional toll road project.

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<sup>6</sup> The ratio that compares owner's equity to borrowed funds.

FDOT will pay the concessionaire milestone payments at various stages of project development and will also provide availability payments to the concessionaire that begin at the completion of construction and will occur annually for 30 years.

### **D.8.3 Lessons Learned from Managed Lanes and Availability Payment Projects**

The lessons to be learned from these newer approaches to toll road transactions include:

- Although direct user tolling is one mechanism for delivering P3 road projects, other mechanisms, including availability and performance payments, might represent a more appropriate risk transfer approach and deliver better value for money.
- TIFIA funding in these projects was critical because it provided funding flexibility in the critical early years of the project
- As each party takes on the risks it is best able to manage, value for money considerations take a more central role instead of simply maximizing upfront public sector financial gain.

### **D.9 Comprehensive Development Agreements and Unsolicited Proposals**

Although the public sector has traditionally assumed the role of developing, defining, and promoting projects, there have been some projects developed under the P3 structure that bring the private sector into the project cycle earlier such as:

- TTC 69 in Texas, which is a Comprehensive Development Agreement (“CDA”)
- I75/I575 in Atlanta, which was an unsolicited bid

However, to date, this model has not been overly successful in the US, which is consistent with experience elsewhere in the world.

#### **D.9.1 TTC I-69 in Texas**

The TTC I-69 is the Texas component of a planned 1,600-mile highway connecting Mexico, the U.S., and Canada, which involves upgrades and improvements in 8 states. In Texas it will run from the Lower Rio Grande River Valley to I-37 and then continue along the south and east portions of Texas from Corpus Christi through Houston all the way to northeast Texas.

In April 2006, TxDOT issued an RFQ for the project. At the time it was called the biggest highway project in Texas. In September 2006, “Bluebonnet Infrastructure Investors” and “Zachry ACS TTC-69 Team” were short-listed to receive Request for Detailed Proposals. The two consortia were bidding to enter into a CDA with the state to design, develop, finance, construct, and maintain the 600-mile multi-use transportation corridor. In March 2008, TxDOT received proposals from the two short-listed consortia and in June 2008, the Zachry/ACS team won the contract to create a master plan for the corridor. At that time it was announced that Zachry/ACS would need up to 18 months to complete the development and financial plans although as of September 2010, there has been no announcement about the signing of the CDA.



Under the planned contract, Zachry/ACS was to have the right of first negotiation to perform work on certain projects. The planning work by Zachry/ACS was to be performed within the constraints prescribed by the Texas Transportation Commission and state law. Zachry/ACS had proposed 7 projects as well as a specific plan for upgrading U.S. Highway 77 from Brownsville to Corpus Christi using toll revenues. The \$2.5 billion upgrade of US 77 was proposed to be the first of the projects developed under the TTC. TxDOT required that separate facility agreements would be needed if it moved forward with the design, construction, financing, maintenance, and operation of any specific projects identified within the master plan.

Since the selection of Zachry/ACS, it appears the most progress has been made by the public sector I-69 segment committees in their work on regional or segment projects.

### **D.9.2 I75/I575 in Atlanta**

In 2003, the Georgia legislature passed a law that allowed for unsolicited proposals to be submitted under what was then known as the Public Private Initiative, or PPI, program. The law allowed private sector entities to submit proposals for public sector projects. The state then reviewed these PPI proposals, made them public, and allowed other companies to submit competing proposals.

Several unsolicited proposals were subsequently submitted, including proposals for:

- GA-316.
- GA-400.
- I-285W/I-20W.
- I-75/I-575.

However, only the I-75/I-575 proposal, which was submitted in November 2004, was advanced. In May 2006, the Georgia Department of Transportation (“GDOT”) announced it signed its first-ever PPI contract – a Developer Services Agreement (“DSA”) – for \$38.5 million with Georgia Transportation Partners (“GTP”), a joint-venture company formed by Bechtel Infrastructure Corporation and Kiewit Southern Co. The GTP team included 19 engineering, financial services, and consulting firms, who along with Bechtel and Kiewit Southern were under contract to perform preliminary engineering and development services in support of transportation improvements to the I-75/I-575 Corridor.

The DSA provided the procedural framework for GDOT and GTP to examine improvements to the I-75/I-575 Corridor. The DSA included a combination of congestion relief options to be studied, including High Occupancy Vehicle, High Occupancy Toll, Express Toll and Truck-Only/Toll lanes, and a Bus Rapid Transit system.

The entire scope of services for the DSA was to be completed no later than July 2009. GDOT Commissioner Harold Linnenkohl said at the time “The PPI process will allow us to evaluate badly needed traffic solutions for this corridor and implement them in a quicker, more efficient and more cost-effective way than under the traditional bid process. This added flexibility helps us keep up with the infrastructure needs of our growing state.”

Under this approach, GDOT was to negotiate a developer service contract with the PPI team that would spell out the PPI team's role in the environmental process. After the environmental process was complete, a design/build contract had to be negotiated. If that contract was negotiated to each party's satisfaction, the PPI team would take over the final design of the project and its construction.

According to the state, if the project was constructed under a traditional approach, where design and construction were authorized under separate contracts, then a 15-20 year timeframe was anticipated. Under the PPI process, it was expected that the project could be completed in as little as 6 years using a design/build approach.

In 2009, the Georgia legislature put in place a new framework empowering the GDOT to identify projects and solicit proposals under what is now known as the Public Private Partnership, or P3, program. Subsequently, GDOT confirmed that it was canceling all un-solicited P3 projects, including the I-75/I-575, and moving ahead with a solicited bidding procurement program instead. The I-75/I-575 is the first of those solicited proposals.

The I-75/I-575 transaction was launched in February 2010 and in June 2010 three teams were pre-qualified:

- West by Northwest Development Partners – Vinci Concessions, OHL Concesiones, Hubbard Construction, Parsons, and Archer Western Contractors.
- Georgia Mobility Partners - Cintra Infraestructuras, Meridiam Infrastructure North America, Soares da Costa, Ferrovia SA, Aecom Services and Prince-SDC Contracting.
- Northwest Atlanta Development Group - ACS Infrastructure Development, Dragados SA, PBS&J and C.W Matthews Contracting.

The bid process is progressing via discussions between the three prequalified teams and GDOT and a formal request for proposals is expected to be issued in early 2011.

The key lesson to learn is that to achieve best value for money (in its widest possible sense), projects need to be defined by the public sector within an overall sector strategy, and then delivered by the private sector through a competitive process that allows a clear comparison of alternative bids.

### **D.9.3 Lessons Learned from CDA's and Unsolicited Proposals**

The track record with these models for procurement has not, to date, been overly successful. In many ways, GDOT highlighted the fundamental issue when it cancelled the unsolicited bid process, started a solicited process instead, and said:

“a solicited approach would allow them to maintain complete control of project identification, selection, procurement and construction and the result is a program that will effectively deliver projects that increase mobility and provide greater options for the traveling public.”

Unsolicited bids and CDA's raise questions about the role of the public and private sectors in P3 projects. To date, as elsewhere in the world, it would appear that for strategic transportation projects, the role of the private sector is seen as one of delivery, not of definition or specification.

## **D.10 On- and Off-Street Parking**

The privatization of off-street (garage) and on-street (metered) parking in the City of Chicago might appear to be similar, but they are very different as described below.

### **D.10.1 Chicago Parking Garages**

Garage parking system in Chicago is considered the largest downtown underground public parking system in the U.S. Income from the garages in 2005 totaled \$16 million. The downtown parking facilities included in the transaction had over 9,000 spaces and four underground parking garages:

- Grant Park North, a three-level facility (two underground) for over 1,800 cars.
- Grant Park South, a four-level facility (three underground) for over 1,300 cars.
- East Monroe Street, a three-level facility (two underground) for over 3,800 cars.
- Millennium Park Garage, a seven-level facility (six underground) for over 2,000 cars.

The East Monroe Street garage required major rehabilitation, including a requirement to perform the work within five years. The city's estimate of the rehabilitation was \$65 million. However, the actual cost was to be determined by the concessionaire and bidders were not asked to specify their estimates. The winning bidder was selected on price only.

The winning team (Morgan Stanley with LAZ Parking as their operator) bid \$563 million for the 99-year concession sale and lease. The garages had income in 2005 of approximately \$16 million, which equates to an earnings multiple of 35 based on the bid price of \$563 million, or 39 based on the bid price plus the estimated \$65 million to rehabilitate the East Monroe Street garage.

Given the relatively small size of the project (from a capital cost perspective) the funding sources for the winning bidder were all equity based.

The city did not impose any restrictions on the parking charges that could be levied at the garages as there are a lot of privately operated parking garages in the city and hence the concessionaire did not have a monopoly position. In addition, there is no revenue/profit sharing with the city.

The city used the proceeds from the sale as follows:

- \$122 million for Chicago park improvements.
- \$120 million for a reserve to generate income to replace the Park District's annual parking fee income of \$5 million.
- \$278 million to pay off all debt associated with the garages.
- \$35 million to rebuild Daley Bicentennial Park when the East Monroe Street garage is rebuilt by the lessee.

- \$8 million for banking, legal, and transaction fees.

The deal appears to have been viewed favorably by both the public and private sectors, and with the exception of a law suit filed by a tax payer organization (which was not permitted to proceed), it also appears to have been broadly accepted by the citizens of Chicago. This positive outcome can probably be attributed to:

- The nature of the asset was clearly definable and, although in public ownership, it neither held a monopoly position nor was viewed as a public service.
- The city was experienced in the privatization process (having successfully completed the Chicago Skyway deal) and was able to apply that experience to define a clear specification to private bidders and articulate clear criteria for the concession award (i.e., the highest price).
- The city was able to present to the public a clear plan for the use of the sale proceeds.
- The market at the time of the deal was relatively buoyant and there was a growing cadre of infrastructure investment funds interested in assets of this nature.

### **D.10.2 Chicago Metered Parking System**

The Chicago metered parking system comprised approximately 36,000 parking spaces on streets throughout the city. In February 2008, the city launched a long term concession sale of these spaces. In March 2008, there were 10 teams that responded to the RFQ. However, the financial crisis was already starting to be felt and the two “Best And Final Offer” bids were only received in early December 2008 (with a third team led by Cintra not submitting).

Two days after submission of bids, the city council voted 40-5 in favor of the transaction in an overwhelming display of support. The winner was Chicago Parking Meters LLC, the consortium led by Morgan Stanley's infrastructure fund.

The winning team bid \$1.15 billion for the 75-year concession. The conditions of sale were the city set the future parking rates and the concessionaire had to update and maintain the parking meter stock. There were some built-in protections for concession revenue related to actions by the city. The concessionaire was to operate and maintain the parking system and collect the revenues, and the city would collect parking fines. The concession agreement included provisions for compensation to the concessionaire for changes in the number of spaces, hours of operation, and parking rates. There is no revenue or profit sharing.

Funding sources were originally all equity. However, in May 2010, the concessionaire closed a long-tenor, forward starting interest rate swap<sup>7</sup>. Five banks acted as swap providers. The interest rate swap was unusual because there was no underlying debt in the transaction. An interest rate swap covers a notional amount which is usually representative of the principal on which interest

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<sup>7</sup> Forward starting swaps lock in the rate today for an asset or liability to be created or sold in the future. A company that plans to issue fixed rate at a future date can use a forward starting swap to hedge the future issuance rate. Forward starting swaps allow companies to take advantage of favorable rates when the market offers them not just when coming to market. Locking in the forward financing costs or investment yields allow the hedger to accurately budget cash flows and expenses related to future projects.

accrues. In this case, the notional amount was \$400 million, which may or may not be equivalent to the amount of debt taken by the concessionaire when debt market terms improve. The intention is that the swap is a hedge against an upward movement in interest rates once the deal is leveraged. Although not an uncommon derivative in the corporate world, this is thought to be the first interest rate swap of its kind for a single asset infrastructure credit.

The project has had a number of high profile opponents and was not, at least initially, popular with the general public.<sup>8</sup>

Not long after the financial close, Chicago's inspector general's office released a report criticizing the deal, claiming Mayor Richard Daley and aldermen had moved too quickly in approving a \$1.15 billion contract. The report claimed city officials made inadequate financial considerations and failed to explore viable alternatives to the 75-year lease as a means to fill the 2009 budget deficit. It also recommended how the city could undertake the lease or sale of public assets in the future using a more deliberative process. Although Mayor Daley dismissed the city inspector general's report, aldermen soon after approved a measure that required a 15-day review period before voting on future privatization deals for major city assets. Therefore, further changes to the way the city seeks future privatization proposals appear likely.

In addition, the transaction received a considerable amount of bad press due to operational problems especially in the first few weeks of the concession. It appears the problems arose because:

- Unlike most P3 deals, parking rates were increased immediately, although the parking meter equipment was being phased in over a much longer replacement period.
- The decision to increase rates before improvements were made generated two issues. First, from a public relations standpoint, this was a mistake because people were unhappy to pay more for no apparent gain or advantage. The private sector operator was accused of “gouging” the public while simply implementing the increases defined by the city in the concession agreement. Second, the meters were not equipped to receive more coins and there were significant increases in break-downs and failures due to full coin boxes, which reflected poorly on the private sector operator.
- The city had kept the bidders at arms length from the asset base during the bid period, but the concession required a lot of activities in the first few weeks of the concession. When the private bidder took over operation it discovered that a lot of the meters were not actually as described in the asset database.
- Consequently, a lot of temporary fixes on the existing meters planned by the private operator were delayed by the need to re-order different parts. These problems might have been eased if there had been a phased transfer of operations, shadow operations/familiarization period, or a more detailed asset database.

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<sup>8</sup> In August 2008, a tax payer organization filed a lawsuit against the City Comptroller, the Illinois Secretary of State, and the Illinois Comptroller. A judge has allowed the case to precede, but removed the Illinois Secretary of State from the list of defendants. As of May 2010, the case had still not been heard in court.

However, the private operator believes that these were temporary problems that were all resolved within the first month of operations (and the level of press criticism has declined significantly since the initial operating period). As of September 2010, the contract appears to be operating well and new meters are being installed in accordance with the concession agreement.

### **D.10.3 Lessons Learned from the Parking Transactions**

The key lesson appears to be that while projects may appear to be similar, all have unique features, and these must be recognized when constructing the term and nature of the deal between the public and private sectors. In particular:

- Although garage and on-street parking may appear to be very similar, they are actually very different. The garages operated in a defined area and competed with other facilities in an open and competitive market. The metered spaces were dispersed, less well defined, and operated as a monopoly in a highly public manner.
- Privatizations are complex by their nature and each needs to be treated in a rational and transparent manner irrespective of any success on earlier deals.
- Although the on-street project may have had initial problems, largely as a consequence of a failure to understand the complexities of the initial hand-over period, the deal is now delivering the stated objectives. As a result, the success or failure of these deals cannot be truly judged for many years.

## **D.11 Infrastructure and Operations in Transit**

The track record on privatizations in the transit market is not very large and not very favorable, with a small number of high profile failures and a number of projects on the drawing board that are making limited progress. However, this is not uncommon given the complex nature of transit deals, which tend to be more difficult to advance than road transactions. Although the record is not very positive to date, recent developments suggest that lessons have been learned.

Three very different examples of infrastructure and operations deals are reviewed:

- Las Vegas Monorail – an example of infrastructure and operations combined.
- Boston Rail Operating Franchise – an example of operations only.
- Denver FasTracks – an example of infrastructure and rolling stock but not operations.

### **D.11.1 Las Vegas Monorail**

The Las Vegas Monorail was originally (1993) a joint venture between MGM Grand and Bally's Hotel to build and operate a 1 mile system linking the hotels and claims a number of firsts:

- It was the first and only privately owned public transportation system in the U.S. and it operated with no public subsidies.
- The MGM Grand-Bally's Monorail Limited Liability Company, which initiated the project, was the first joint venture between competing hotels/casinos.

Originally, the Las Vegas Monorail was not a typical transit project. However, in 1997 the State of Nevada passed legislation that enabled a private company to own, operate, and charge a fare as a public monorail system. Subsequently, in 2000, the non-profit public benefit corporation, LVMC, was formed, and it acquired the original Monorail system under a 50-year franchise agreement. A key objective of this change in 2000 was to allow the expansion of the monorail using private funds.

The funding source for the expansion of the system by LVMC was tax-exempt revenue bonds backed by fares and advertising revenues. For tax purposes, the Monorail is registered as a not-for-profit company as it provides a public service per Nevada law. Similar to the Pocahontas and Denver North West Parkway transactions, LVMC was a “63-20 corporation and ultimately suffered a similar fate as those projects.

The MGM Grand-Bally's Monorail limited liability company's rights to the initial monorail project, which were granted under a franchise agreement with Clark County, were granted to LVMC under a new franchise agreement.

LVMC then entered into a management contract with Transit Systems Management LLC, for the construction, operation, and management of the project, which was upgraded and expanded to 3.9 miles with 7 stops. This expanded Las Vegas Monorail opened in July 2004 but suffered mechanical failures in September that caused it to be shut down until the end of December 2004. However, it has operated reliably since that time.

Bombardier Transportation is contracted to operate and maintain the Las Vegas Monorail system. In January 2009, they received the first 5-year option order to continue to operate the system

Revenue bonds were issued by the Nevada Department of Business and Industry on behalf of LVMC. LVMC maintains a collection fund from which it pays operations and maintenance costs first and then transfers net project revenues on a monthly basis to the trustee for loan payments to pay debt service payments on the bonds and to maintain a debt service reserve. LVMC also maintains a separate capital replacement fund. Although LVMC has executed a management contract which includes an O&M agreement, its fare box, advertising, and other project revenues remain the property of LVMC.

Patronage and revenue levels have not met expectations and in January 2010 the Las Vegas Monorail filed for Chapter 11 Bankruptcy Protection. The filing is not expected to affect system operations or impact the monorail's hours of operation or service to its customers.

There appear to be a number of issues that arise from this case:

- It is very rare to find anywhere in the world a transit system that does not rely on some form of public subsidy. Although the original promoters of the monorail (two hotels) were clearly viewing the project from a very different perspective than most traditional transit projects, the decision in 2000 to expand the system should have raised the issue of sustainability without a subsidy.

- This transaction again raises questions about 63-20 corporations and whether such structures transfer sufficient risk to the private sector promoters of the project.

### **D.11.2 Boston Rail Operating Franchise**

The Boston Rail Operating Franchise is an example of a franchise to operate rail services across an existing rail network. The Boston Rail Operating Franchise is a fully integrated train operation for the 13-line urban rail network around Boston. It includes track maintenance, station management, ticket selling, and train operation and control.

Massachusetts Bay Transit Authority (“MBTA”) is the owner of the system and promoter of the operating franchise. The Massachusetts Bay Commuter Railroad Company (“MBCRC”) is the current franchise holder.

The current concession was awarded in July 2003 to MBCR. The MBCR contract originally expired in July 2008, but included an additional 5-year option. This option was taken, with the franchise originally extended by 3 years to July 2011 and then later by another 2 years to July 2013.

The project had a very different approach to risk transfer than the Las Vegas Monorail project, with the public sector retaining a lot more of the risks, which it was better positioned to manage. For example, this different approach to risk transfer included the following:

- It was a fixed price franchise committed for the length of concession, although MBTA took the risk on fuel costs.
- The payments to MBCR are made based on performance. There is no patronage and/or revenue risk with the franchise holder. Further, any major capital development (e.g. new rolling stock or stations) would involve additional payments to MBCR.
- The concession required MBCR to demonstrate how they would deal with extreme winter weather, but MBTA set aside the additional funding for the annual snow plan. In other words, the cost associated with the risk of severe weather was retained by the public sector, although the delivery risk for the winter weather plan was retained by the private sector.

The concession also followed other state contracts in requiring a minimum percentage of the contract to be provided by “disadvantaged suppliers,” which was 11.5% by value.

As noted above, MBCR secured two extensions of the concession, which is proof that the franchise is perceived as a success. The reasons for this appear to be in part attributable to a balanced transfer of risk between the public and private sector to the parties best able to manage that risk.

### **D.11.3 Denver FasTracks**

Denver FasTracks is a different model of transit privatization in that it includes infrastructure and track maintenance but not operations, although it is adopting many of the risk allocation policies employed in the Boston franchise.



FasTracks was approved in 2004 and was intended to expand and improve the Regional Transportation District's (RTD) rail and light rail connections. However, there was an acknowledged significant funding shortfall and the RTD proposed to bridge the gap using alternative financing strategies, including P3s.

The Eagle P3 (as the arrangement is called) consists of the East Corridor, Gold Line, Commuter Rail Maintenance Facility, and an initial segment of the Northwest Rail Corridor. RTD will have 47 miles of new rail under construction or under contract, which is more than double the amount of rail in RTD's existing light rail system. It also represents nearly 40% of the total FasTracks rail network now under contract.

The East Corridor is a 23 mile electric commuter rail corridor that runs from Denver Union Station to Denver International Airport. Five intermediate stations are included: 38th/Blake, Colorado, Central Park Blvd., Peoria/Smith Rd. and Airport Blvd/40th Ave. The Gold Line is an 11.2-mile electric commuter rail transit corridor that connects Denver Union Station to Ward Road in Wheat Ridge. It passes through northwest Denver, Adams County, and Arvada. There are six intermediate stations, including 41st Avenue, Pecos, Federal, Sheridan, Olde Town Arvada and Arvada Ridge. The Commuter Rail Maintenance Facility will be the site to repair, clean, fuel, and store the vehicles that will serve the four FasTracks commuter rail corridors: East, Gold Line, Northwest Rail, and North Metro. The portion of Northwest Rail included in the Eagle P3 includes shared tracks with the Gold Line from Denver Union Station to Pecos Street, plus an additional two miles north, to the South Westminster Station, at 71st Avenue and Lowell Boulevard in Westminster.

Phase I of the project includes property acquisition, construction of the East Corridor, construction of the Maintenance Facility, and the purchase of Electric Multiple Unit (EMU) rail vehicles. Phase I is scheduled to begin in August 2010. Phase II of the project includes the Gold Line and the short segment of Northwest Rail. Phase II is scheduled to begin following the award of a Full Funding Grant Agreement (FFGA) by the Federal Transit Administration in 2011.

In June 2010, RTD selected the consortium led initially by Macquarie and Fluor, known as Denver Transit Partners (DTP). The consortium will design, build, operate, and maintain the project under a 34-year contract in return for annual performance-based payments. RTD expects the project to attract \$1 billion in 2011 through the Federal Transit Administration ("FTA") Full Funding Grant Agreement process. In addition, between \$400 million and \$500 million of tax-exempt PABs will be issued with a 30-year maturity.

RTD believes the deal has delivered considerable value. For example:

- DTP's proposal is \$300 million lower than RTD's budget estimate of \$2.3 billion. DTP offers a price (defined as Annual Service Payments) which are nearly half of RTD's estimated affordability limit for the project.
- Enhancements proposed by DTP include (1) approximately 6 miles of single track on the East Corridor to reduce construction costs without negatively impacting operating performance, (2) track configuration changes including the addition of "pocket" tracks and the rearrangement of turnouts and crossovers to enhance operational flexibility, (3)

standardization of bridge elements to simplify construction, (4) modifications to the Commuter Rail Maintenance Facility to improve efficiency; and (5) a new high-quality commuter rail vehicle design that provides greater seating capacity, storage for bicycles/luggage, and enhanced security features such as interior CCTV monitoring.

- DTP plans to complete all 3 commuter rail lines ahead of schedule and will complete the East Corridor by January 2016 – nearly one year earlier than RTD’s deadline.
- DTP’s proposal incorporates a state-of-the-art train control system, including a fully redundant communications system and full Positive Train Control (PTC) functionality that will meet the requirements of the 2008 Railroad Safety Improvement Act.

Another interesting feature of this deal is that RTD will pay the other bidding consortium, led by HSBC Infrastructure, Siemens, and Veolia, a \$2.5 million stipend for the intellectual property in its proposal. That gives RTD the further option to use cost-saving ideas from this proposal.

Although this deal is a good example of how involving the private sector can deliver additional funding as well as additional benefits through innovation, it has not been without problems. In particular, it has taken a long time for this transaction to evolve.

- 2004 – FasTracks was approved in 2004 and was intended to expand and improve the Regional Transportation District's (RTD) rail and light rail connections. It was acknowledged that P3 would be needed as one of the ways to fill an identified funding gap.
- Late 2007 and Early 2008 – Legal and financial advisors were appointed by RTD to assist with the P3 process.
- October and November 2008 – Statements of Qualifications (“SOQ”) were received from 3 teams, with all 3 being short listed for the RFP stage.
- October 2009 – The RFP was issued to the 3 teams. In the intervening period some team members in the consortia had already changed.
- November 2009 – One of the consortium dropped out of the project citing changes in circumstances since the original SOQ.
- April 2010 – Technical proposals submitted by the 2 remaining teams.
- May 2010 – Final proposals submitted by the 2 teams and there was a public presentation of the proposals.
- June 2010 – The winning bidder is named.

The long timeline has clearly been problematic, and has not been assisted by the financial crisis, with a number of consortia members dropping out and new members joining.

In fact, only days after being named bidder in June 2010, Macquarie announced that it intended to sell its equity prior to the financial close. The Uberior Group and John Laing, which are experienced infrastructure investors, have taken Macquarie’s place as equity sponsors. In fact, John Laing had been a member of the consortium that pulled out of the bidding process in November 2009 (although it had left the consortium prior to that date).

### **D.11.4 Lessons Learned from Transit**

The key lessons to be learned from these transit cases are:

- The complexity of transit projects is not, in itself, a barrier to the application of privatization techniques.
- The Las Vegas Monorail demonstrates that the involvement of the private sector cannot fundamentally change the nature of a project – in this case, that transit projects need a public subsidy to be viable.
- The Boston Rail Operating Franchise shows that with the correct risk transfer arrangement, privatization can deliver top quality services to the travelling public and value for money, and that this risk transfer does not need to include patronage or revenue risk.
- It appears likely that the structure adopted by RTD will achieve an investment grade rating on their PAB's for the Eagle P3 deal (although at the low end of the scale).
- The very complexity of transit deals creates opportunities for the private sector to innovate in delivery, saving money, and delivering services earlier than expected.

### **D.12 Ports**

Port privatization has served as an effective tool for attracting private investment to port facilities worldwide in lieu of public funds. The vast majority of investments in new port terminals around the world in the last ten years have been done via private investments. However, the U.S. is one of the very few countries that generally has not embraced private investment in port terminals. This is due in part because ports in the U.S. are seen as having “strategic importance,” as most clearly demonstrated by the DP World controversy.

In October 2005, Dubai Ports World (“DPW”), a state-owned company in the United Arab Emirates (“UAE”), approached the Committee on Foreign Investment in the United States (“CFIUS”) to clear regulatory hurdles for a possible acquisition of the British firm Peninsular and Oriental Steam Navigation Company (“P&O”). The CFIUS is the multi-agency federal panel that reviews transaction with foreign corporations that raise antitrust or national security questions. P&O held the management contract for 6 major U.S. port facilities (New York, New Jersey, Philadelphia, Baltimore, New Orleans and Miami) plus operations in 16 other ports. In February 2006, the stockholders of P&O agreed to sell their company to DPW.<sup>9</sup> The issue rose to prominence as a national security debate. The issue was whether such a sale to a company based in the UAE would compromise port security.

On March 8, 2006, the U.S. House Appropriations Committee voted 62–2 to block the deal, and Senator Charles Schumer added amendments to a senate bill to block the deal, causing an uproar in the Senate.<sup>10</sup> On March 9, 2006, DPW released a statement saying they would turn over operation of U.S. ports to a U.S. entity.<sup>11</sup> In December 2006, DPW sold P&O's U.S. port

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<sup>9</sup> Wikipedia, accessed October 2, 2010.

<sup>10</sup> “House Panel Votes to Block Ports Deal,” Fox News, March 9, 2006.

<sup>11</sup> “Dubai Company Gives Up On Ports Deal,” CBS Broadcasting Inc., March 9, 2006.

operations to AIG Global Investment Group, a New York-based asset management company with no experience in port operations.<sup>12</sup>

Although there is fundamentally no reason why ports cannot utilize privatization approaches to develop their infrastructure (as they have elsewhere in the world), to date there have been very few deals that would fall within this definition, and the “strategic role and security” issue may account for part of this. However, two port privatization projects have recently closed as discussed below.

### **D.12.1 Seagirt Terminal, Baltimore Harbor**

The Port of Baltimore has been in operation for over 300 years. In 2008, the port handled about 40 million tons. Seagirt is the largest facility in Baltimore Harbor and commenced operations in 1990. It has a current minimum annual capacity of 1.0 million twenty-foot equivalent units (“TEUs”) across its 3 berths and in 2008, handled 500,000 TEUs. The terminal is owned by the Maryland Transportation Authority (MdTA).

The transaction time line was as follows:

- Transaction launched in April 2009.
- In July 2009, the pre-qualified bidders were Ports America (Ports America Baltimore), Ceres, and Alinda Capital Partners LLC.
- The preferred bidder, Ports America (Ports America Baltimore), was chosen in November 2009.
- The financial closing occurred in January 2010

The deal was valued at \$334 million, with an 18:82 split between equity and debt. The concessionaire will operate the Seagirt Marine Terminal, build a new 50-foot berth, and purchase 4 new cranes and as part of the 50-year lease. The concessionaire will benefit from a revenue sharing structure above a certain level of container volume use at the facility.

MdTA plans to reinvest funds from this concession as part of a capital program that will allow major highway-related projects to proceed, including upgrades to I-95, the US 40 Hatem Bridge, and the US 50/301 Bay Bridge. It will also fund a repayment to MdTA for investment in Seagirt, as well as provide ongoing revenues for administrative and other port purposes.

The cost of building the new berth is estimated to be slightly over \$100 million. The upfront payment is thought to be between \$200 million and \$250 million. The anticipated capital investment in projects at the port over the 50-year lease is \$500 million.

Because the financial close occurred in early 2010, it is too early to draw conclusions on how the project will progress.

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<sup>12</sup> King Jr., N.; Hitt, G. (“Dubai Ports World Sells U.S. Assets,” The Wall Street Journal. <http://online.wsj.com/article/SB116584567567746444.html>, December 12, 2006.

### **D.12.2 Port of Oakland Outer Harbor**

The Port of Oakland was established in 1927 and is now a major intermodal container port, ranking as the 4th busiest container port in the U.S. The port has 20 deepwater berths, 35 container cranes, 10 container terminals, and 2 intermodal rail facilities, which handle over 2 million containers a year.

In March 2009, Port of Oakland selected Ports America Outer Harbor Terminal, LLC (“PAOH”) through a competitive process to upgrade and operate 5 container berths in the Port of Oakland (berths 20 through 24) through a 50-year concession and lease agreement.<sup>13</sup> PAOH took over management of the terminal in January 2010.

The area accounts for approximately 4,400 feet of berth with about 160 acres of storage space for a total of approximately 175 acres. In addition, the concession agreement allows for the opportunity for the concessionaire to acquire the adjacent berths 25 and 26 when the current use agreement for that area expires (as early as June 30, 2013). The combined areas (Berths 20-26) would bring the total berth length to more than 5,500 feet or the equivalent of berthing 5 to 6 container ships in a row depending on the size of the vessels.

As a first step the investment, PAOH proposed \$150 million to upgrade 160 acres within the Port, comprising some 4,400 feet of berth. During the life of its operational stewardship at the Port, PAOH plans to invest \$2.5 billion to improve the competitiveness of the Port.<sup>14</sup>

PAOH is paying a \$60 million up front fee to the Port of Oakland and an annual rent of at least \$19.5 million, with the figure rising each year.

Although the agreement will save the Port of Oakland \$3 million in annual debt service, this was not the only consideration, with environmental benefits also considered in the bid evaluation. PAOH estimates that when their build out is completed, emissions per TEU could be reduced by as much as 90% due to electric stacking cranes rather than diesel, no truck idling and fewer miles driven within the yard, ship to shore power and truck appointments.

Although it is too early to draw conclusions, there are a number of interesting features to note:

- The deal can be expanded later as other existing terminal contracts end.
- The procurement award criteria included environmental benefits as well as financial gain.
- The private sector payments are a mix of an upfront payment and annual rent.

### **D.12.3 Lessons Learned from Ports**

Although the strategic nature and importance of ports is highlighted by the DPW controversy, the Seagirt and Oakland examples demonstrate that privatization can be applied to port assets.

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<sup>13</sup> Press Release, Port of Oakland, March 4, 2009.

<sup>14</sup> Ibid.

Also, the use of more flexible approaches to the award, such as future expansion to other operations and the mix of upfront and annual rent, and the inclusion of environmental benefits in the award criteria all point to this sector recognizing that the privatization process is flexible and can (and should) be adapted to meet the specific requirements of each situation.

The inclusion of environmental benefits within the bid evaluation criteria has particular resonance with the airport and aviation industry.

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## Appendix D.1

### Transportation Infrastructure Finance and Innovation Act (TIFIA)

The Transportation Infrastructure Finance and Innovation Act of 1998 (TIFIA) created a program that provides credit assistance for qualified projects of regional and national significance. The TIFIA credit program is designed to fill market gaps and leverage substantial private co-investment by providing supplemental and subordinate capital.

The program's fundamental goal is to leverage federal funds by attracting substantial private and other non-federal co-investment in critical improvements to the nation's surface transportation system.

TIFIA was created because entities that sought to finance large-scale transportation projects with tolls often had difficulty obtaining financing at reasonable rates due to the uncertainties associated with these revenue streams, especially for green field sites and in the early years of a project.

The TIFIA credit program offers three distinct types of financial assistance designed to address the varying requirements of projects throughout their life cycles:

- Secured (direct) loan—Offers flexible repayment terms and provides combined construction and permanent financing of capital costs. Maximum term of 35 years from substantial completion. Repayments can start up to five years after substantial completion to allow time for facility construction and ramp-up.
- Loan guarantee—Provides full-faith-and-credit guarantees by the federal government and guarantees a borrower's repayments to non-federal lender. Loan repayments to lender must commence no later than 5 years after substantial completion of the project.
- Standby line of credit—Represents a secondary source of funding in the form of a contingent federal loan to supplement project revenues, if needed, during the first 10 years of project operations, and is available for up to 10 years after substantial completion of the project.

The amount of federal credit assistance may not exceed 33% of total reasonably anticipated eligible project costs and the exact terms for each loan are negotiated between the USDOT and the borrower based on the project economics, the cost and revenue profile of the project, and other relevant factors. For example, USDOT policy does not generally permit equity investors to receive project returns unless the borrower is current on TIFIA interest payments.



## Appendix D.2

### European Investment Bank Loan Guarantee Instrument

The European Investment Bank (“EIB”) was created by the Treaty of Rome in 1958 as the long-term lending bank of the European Union (“EU”). The task of the EIB is to contribute towards the integration, balanced development, and economic and social cohesion of EU Member States. The EIB raises substantial volumes of funds on the capital markets, which it lends on favorable terms to projects that further EU policy. In particular, the EIB:

- Enjoys its own legal stature and financial autonomy within the EU.
- Operates under strict banking practices and in close collaboration with the wider banking community, both when borrowing on the capital markets and when financing capital projects.

The Loan Guarantee Instrument for Trans-European Transport Network Projects (“LGTT”) is an innovative financial instrument set up and developed by the EU and the EIB which aims to facilitate a larger participation of the private sector involvement in the financing of Trans-European Transport Network infrastructure (“TEN-T”). This instrument facilitates private sector involvement in core European transport infrastructure, which often faces difficulties in attracting private-sector funding due to the relatively high levels of revenue risk in a project’s early operating stages.

The LGTT facilitates investment in TEN-T projects by significantly improving the ability of the borrower to service senior debt during the initial operating period or “ramp-up” phase of the project. It is designed to enhance the credit quality of the senior credit facilities, thereby encouraging a reduction of risk margins applied to senior loans to a project. These savings should surpass the cost to the borrower of the guarantee, resulting in a financial value-added for the project.

The stand-by liquidity facility guaranteed by the LGTT should not normally exceed 10% of the total amount of the senior debt (up to 20% in exceptional cases e.g. high traffic volatility during the ramp-up period with strong indication of stabilized traffic and acceptable debt service capacity post ramp-up). The amount of the guarantee is subject to a maximum ceiling of €200 million per project.

Under the LGTT the EIB will accept exposure to higher financial risks than under its normal lending activities. In effect, if the EIB guarantee is called upon by the stand-by liquidity facility (“SBF”) providers at the end of the availability period, then the EIB would reimburse the SBF providers and become a subordinated lender to the project but ahead of any payment to the equity providers and related financings.

Once the EIB has become a creditor to the project, amounts due under the LGTT will also rank junior to the debt service of the senior credit facility. The EIB, by taking such subordinated risk through the LGTT guarantee, will help the project to cope with the revenue risk of the early years

of operation (the first 5 to 7 years) while relying on the long-term perspective of the project to be financially viable.

This is clearly a facility which addresses one of the fundamental concerns with toll roads linked to development, namely that while long term viability appears strong, short term revenue problems can arise. Although not available in the U.S., this does present a “conceptual” solution for toll road funders to follow, and as discussed below, similar U.S. equivalent solutions, such as TIFIA, are now starting to appear regularly in toll road project funding.

The public sector has an important role to play in addressing early revenue risk in facilities such as toll roads if value for money is to be achieved using P3 structures.

## **Appendix D.3**

### **Non-Airport Privatization Transaction Summaries**

### Chicago Skyway

Item	Description
<b>Ownership</b>	Skyway Concession Company, LLC (SCC) – which consists of equity partners Cintra Concesiones de Infraestructuras de Transporte, S.A. and Macquarie Infrastructure Group/Macquarie Infrastructure Partners. The Project Sponsor is the City of Chicago.
<b>Operational Details</b>	A 7.8 mile, 6-lane divided, elevated highway including a 3.5-mile elevated structure crossing the Calumet River. Built in 1958, it connects I-94 (Dan Ryan Expressway) in Chicago to I-90 (Indiana Toll Road) at the Indiana border. The car toll (2010) is \$3.00, with trucks paying \$1.80 per axle (and which are 40% higher between 4am - 8pm). Toll price escalation was covered by a specified toll regime from 2008 to 2017, followed by greater of 2%, CPI or Nominal GDP per capita.
<b>Type of privatization</b>	Long term (99 year) lease of an existing toll road asset.
<b>Date of Transaction</b>	Financial close was October 2004.
<b>Valuation</b>	\$1.83 billion upfront payment
<b>Description of transaction</b>	Request for Qualifications (RFQ) issued in March 2004 by the City of Chicago. Ten responses were received and 5 groups were invited in May 2004 to prepare proposals. Three bids were submitted in October 2004. The long term lease awarded in October 2004. Cintra/Macquarie bid \$1.83 billion, 2.6 times as much as the next highest bidder, a French and Canadian group led by Vinci Concessions. Abertis Infraestructuras of Spain was the only other bidder, offering \$505 million for the lease. The conditions of sale were that in January 2005 the SCC assumed operations of the Chicago Skyway. SCC is responsible for all operating and maintenance costs of the Skyway. It has the right to all toll and concession revenue. No revenue-sharing and no non-compete clause.
<b>Other Features</b>	The original financial structure (backed by toll receipts) had Cintra equity at \$485 million, Macquarie equity at \$397 million and Bank Loans of \$948 million. Subsequent refinancing saw the Cintra/Macquarie equity fall to \$510 million, with Capital accretion bonds of \$961 million (21-year maturity; 5.6% interest rate), Current interest bonds of \$439 million (12-year maturity), and Subordinated bank debt of \$150 million (Banco Bilbao Vizcaya Argentaria, Santander Central Hispano and Calyon).

**Indiana Toll Road (I-90)**

<b>Item</b>	<b>Description</b>
<b>Ownership</b>	Equity partners: Statewide Mobility Partners Consortium - Cintra Concesiones de Infraestructuras de Transporte, S.A. (50%) and Macquarie Infrastructure Group/Macquarie Infrastructure Partners (50%). The Project Sponsor is Indiana Finance Authority (IFA), on behalf of Indiana DOT.
<b>Operational Details</b>	Length of 157 miles (from Ohio to Illinois). It provides the primary connection to the Chicago Skyway. The Indiana Toll Road links the largest cities on the Great Lakes with the Eastern Seaboard. Connections with I-65 and I-69 lead to major destinations in the South and on the Gulf Coast. The toll (2010) is: 2-axles at \$4.65 with i-zoom and \$8.00 without i-zoom. 3-axles at \$11.75, 4 axles at \$24.50, 5 axles for \$32.00 and 6 axles for \$37.50, and 7 or more axles at \$69.75. Annual toll increase capped at highest of 2%, CPI or per capita GDP increase.
<b>Type of privatization</b>	Long term (75 year) lease of an existing toll road asset
<b>Date of Transaction</b>	Financial close June 29, 2006.
<b>Valuation</b>	\$3.8 billion
<b>Description of transaction</b>	Enabling Legislation: House Enrolled Act 1008 (HEA 1008), known as "Major Moves," signed into law in March 2006. Request for Toll Road Concessionaire Proposals released by IFA in September 2005. The lease concession awarded to Indiana Toll Road Concession Company, LLC (ITRCC) comprised of an even partnership between Cintra and Macquarie. In April 2006, ITRCC and IFA executed the "Indiana Toll Road Concession and Lease Agreement" providing for a 75-year lease. ITRCC submitted the highest bid of \$3.8 billion. Other bidders included a group led by Babcock & Brown (\$2.84 billion), an all Spanish group (\$2.52 billion), and Kwame Parker (\$1.9 billion). The concession does not allow for revenue sharing and a non-compete clause is included.
<b>Other Features</b>	Funding source consisted of: Cintra Equity and Macquarie Equity of \$374 million each and Senior bank debt - \$3,030 million. Senior bank debt was provided by a 7-bank club comprising Banco Bilbao Vizcaya Argentaria SA, Banco Santander Central Hispano SA, Caja de Ahorros y Monte de Piedad de Madrid, BNP Paribas, DEPPFA Bank, RBS Securities Corporation and Dexia Credit Local. The state has allocated the funds from the lease towards road projects, paying off existing toll road bonds and establishing two transportation project funds.

### Pennsylvania Turnpike

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Item	Description
<b>Ownership</b>	Grantor: Office of the Governor of Pennsylvania
<b>Operational Details</b>	Operated by the Pennsylvania Turnpike Commission and serving most Pennsylvania's major urban areas, it encompasses 532 miles (856 km) in three sections. Its main section, extending from the Ohio state line in the west to the New Jersey state line in the east, is 359 miles (578 km). Its Northeast Extension, extending from Plymouth Meeting in the southeast to Wilkes-Barre and Scranton in the northeast, is 110 miles (180 km). Its various access segments in Western Pennsylvania total 62 miles (100 km). Construction on the Turnpike began in 1937 and was completed from Ohio to New Jersey in 1956. Most of the toll road operates as a paper-ticket toll road. E-ZPass is accepted in designated lanes at all toll plazas. As of March 2010, the fare for a two-axle automobile travelling the entire Turnpike eastbound from the Warrendale Gate to the end of the Turnpike at the Delaware River Bridge into New Jersey, a distance of 329 miles (529 km), costs \$29.35, or by travelling from Warrendale to the Wyoming Valley exit near the end of the Northeast Extension, a distance of 409 miles (658 km), costs \$33.20. A 3% toll increase went into effect on January 3, 2010. The Turnpike handles over 172 million vehicles/ year (2009). Expansion from 4 to 6 lanes is being undertaken on this toll road.
<b>Type of privatization</b>	Cancelled (The target was a long-term lease of existing asset)
<b>Date of Transaction</b>	n.a.
<b>Valuation</b>	n.a.
<b>Description of transaction</b>	In November 2006, Pennsylvania Governor Ed Rendell raised the idea of a long-term lease of the turnpike to a private group as a means of raising money to improve other infrastructure within the state, following examples of similar toll road lease arrangements in Illinois, Indiana, Texas, and Virginia. In October 2007, 34 companies submitted 14 proposals to leasing the turnpike. On May 19, 2008, the Spanish firm Abertis Infraestructuras, SA and Citi Infrastructure Investors of New York City submitted a record \$12.8 billion proposal to lease the turnpike. However, the proposal failed to obtain legislative approval and the offer was withdrawn by Abertis and Citi.

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### Alligator Alley

<b>Item</b>	<b>Description</b>
<b>Ownership</b>	Florida Department of Transportation (FDOT) which is still exploring P3 options for operating this Concession after a failed bid process in 2009.
<b>Operational Details</b>	<p>It is a section of Interstate 75 (State Road 93) and State Road 84 extending from Naples on the west coast of Florida to Weston on the east. First opened in 1969, most of the highway traverses the Everglades and is also known as the Everglades Parkway. Originally built as a two-lane toll road connecting the two coasts of Florida. Widened to 4-lane in 1992.</p> <p>Automobile drivers pay a \$2.50 toll (\$2.00 for SunPass users).</p>
<b>Type of privatization</b>	A Long Term Lease (50 to 75 years) was proposed but not bids received
<b>Date of Transaction</b>	Process was abandoned in May 2009
<b>Valuation</b>	n.a.
<b>Description of transaction</b>	<p>Since 2008, FDOT has been considering a concession period from 50 to 75 years for Alligator Alley, depending on the offers presented. The department said it would award the lease to the bidder with the largest upfront payment and the project will include some revenue-sharing as required by state law. In 2009, at least two groups were preparing bids for the asset, although both failed to submit proposals by the May 18, 2009 deadline. These were:</p> <ul style="list-style-type: none"><li>• a consortium of Vinci and Alinda advised by RBC Capital Markets (financial) and Chadbourne &amp; Parke (legal).</li><li>• a Global Via/ Atlantia pairing advised by SG and JPMorgan (financial) and Latham &amp; Watkins and Greenberg Traurig (legal).</li></ul> <p>FDOT continues to look at options for leasing the Alley and the use of P3 for monetization.</p>
<b>Other Features</b>	The proposal involved no upgrades or improvements to the system and toll increases

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**Pocahontas Parkway**

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<b>Item</b>	<b>Description</b>
<b>Ownership</b>	Transurban USA. <b>Project Sponsor is the</b> Virginia Department of Transportation (VDOT) and the Pocahontas Parkway Association
<b>Operational Details</b>	The Pocahontas Parkway (Route 895) is an 8.8-mile tolled highway seven miles south of Richmond, Virginia. The four-lane road connects Chippenham Parkway at I-95 in Chesterfield County with Interstate 295 south of the Richmond International Airport in Henrico County. Construction began in the fall 1998, and the Parkway was opened to traffic in stages beginning in May 2002.
<b>Type of privatization</b>	99 year lease of relatively new asset plus construction of new extension
<b>Date of Transaction</b>	Fiscal year 2007
<b>Valuation</b>	\$597.4 million including refinancing, construction of the RAC and installation of an electronic tolling system
<b>Description of transaction</b>	The Parkway was constructed using funds generated by bonds issued by the Pocahontas Parkway Association (PPA) in 1998 under Virginia's Public Private Transportation Act of 1995. The PPA was established for the sole purpose of financing the construction of the Parkway. The Parkway's total development costs were funded through tax-exempt revenue bonds (\$354 million) issued by PPA, a State Infrastructure Bank loan (\$18 million) and Federal funding for roadway design (\$9 million). Transurban executed an Asset Purchase Agreement with the Pocahontas Parkway Association, a 63-20 non-profit corporation, and entered into the Amended and Restated Comprehensive Agreement (ARCA) with VDOT on June 29, 2006. Hence Transurban has acquired the sole rights to enhance, manage, operate, maintain, and collect tolls on the Parkway for a period of 99 years. Transurban has also defeased all of PPA's underlying debt and is obligated to construct the Richmond Airport Connector (RAC), a 1.58-mile, four-lane extension of the toll road to Richmond International Airport.
<b>Other Features</b>	Funding Sources for the Original construction were 63-20 corporation tax-exempt toll revenue bonds - \$354 million, SIB loan - \$18 million and Federal funds for design costs - \$9 million. Funding for the long-term lease (2006) were Senior bank debt - \$420 million, Subordinated debt - \$55 million, Equity contribution - \$141 million and TIFIA loan - \$150 million

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**Northwest Parkway, Denver, Colorado**

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<b>Item</b>	<b>Description</b>
<b>Ownership</b>	Operated & managed by Northwest Parkway LLC- whose sole shareholder is Brisa Auto Estradas de Portugal S.A.
<b>Operational Details</b>	The project consists of the two-mile Interlocken Loop between SH128 and Tape Drive and a nine-mile limited access toll road between Tape Drive and I-25 with a connection to E-470. It is Colorado's newest toll road and opened on November 24 <sup>th</sup> , 2003. The toll is \$3.10 for 2-axle vehicles and \$3.10 per additional axle on the Main tollway. There is a \$1.00 toll on the ramps. Go-Pass and Express Toll customers receive a 20% discount on ramp locations.
<b>Type of privatization</b>	99 year lease of a relatively new asset
<b>Date of Transaction</b>	November 2007
<b>Valuation</b>	\$600 million
<b>Description of transaction</b>	The parkway was originally built with \$416.4 million in bonds, to be paid back with toll revenue over 35 years. The road opened in 2003. Due to very low traffic levels, relatively to forecast, there were concerns over debt repayment and public sector sought a private investor on a long term lease. In September 2006 an RFQ was issued to private sector financial groups. In April 2007 Brisa/CCR was named preferred bidder and in November 2007 Financial Close reached. Later Brisa became the sole owner.
<b>Other Features</b>	The project financing did prove problematic. Initially Brisa had to increase the level of equity it planned to commit to reach financial close. Then, when the debt went to syndication in early 2008 it suffered delays as a consequence of a tightening market and a general lack of enthusiasm for the deal, although syndication was ultimately achieved.

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**South Bay Expressway (SBX), San Diego County, California**

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<b>Item</b>	<b>Description</b>
<b>Ownership</b>	South Bay Expressway, L.P. (Earlier California Transportation Ventures) - Owned by Macquarie Infrastructure Group and Macquarie Infrastructure Partners. The Project Sponsor was Caltrans.
<b>Operational Details</b>	A 9.3 mile, 4-lane divided highway from SR 905 (international border) to SR 54 (near San Diego). The car toll (2010) varies from \$0.75 to \$3.85 on FastTrak tag and \$2.50 to \$4.50 by cash. Trucks with 3 to 4 axles pay 2 times car toll and trucks with 5 or more axles pay 3 times car toll.
<b>Type of privatization</b>	35 year Build-Transfer-Operate franchise.
<b>Date of Transaction</b>	Financial close May 2003 and opened to traffic in November 2007.
<b>Valuation</b>	Cost: \$658 million for the Southern 9.3-mile section and \$138 million for the Northern 3.2-mile Connector.
<b>Description of transaction</b>	Enabling legislation: California's AB 680 legislation passed in 1989 and funded by loan under TIFIA- Transport Infrastructure Finance and Innovation Act, 1998. The conditions of sale were that a limited partnership holds a franchise with the State of California under which it financed and built the highway, then transferred ownership to the State. The limited partnership then leases back, operates, and maintains the facility for 35 years. In 2042, control goes back to the State at no cost. Funding sources for the Southern Toll Section were Investor equity, bank debt (\$470 million), TIFIA loan (\$140 million), and donated right of way (\$48 million). For the Northern Gap & Connector section it was federal funds (Federal aid receipts) and local sales tax receipts.
<b>Other Features</b>	The northern 3.2-mile segment, including the SR 54 interchange, was financed publicly using a mix of federal funds and local sales tax proceeds. Both sections were built by the same contractor under two separate design-build contracts. The franchise allows a maximum 18.5% return on total investment with an additional incentive return for action to increase average vehicle occupancy on the toll road. In March 2010, South Bay Expressway, L.P. and California Transportation Ventures, Inc. filed petitions in the United States Bankruptcy Court for the Southern District of California seeking relief under chapter 11 of Bankruptcy Code.

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**Dulles Greenway**

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<b>Item</b>	<b>Description</b>
<b>Ownership</b>	Owner: TRIP II a special purpose company that has had numerous share holders over time (see below). The operator is Autostrade International, a subsidiary of Italian-based Autostrade S.p.A.
<b>Operational Details</b>	The Dulles Greenway is 14-mile long and carries traffic between the Capital Beltway and Dulles Airport.
<b>Type of privatization</b>	Long term lease of a new toll road asset
<b>Date of Transaction</b>	Opened September 1995
<b>Valuation</b>	\$350 million
<b>Description of transaction</b>	The Greenway was privately financed and constructed from 1993 to 1995 as a DBFO and had an initial agreement to have operational responsibilities revert to the Commonwealth of Virginia in 2036. To finance the Greenway, the limited private partnership, TRIP II put up \$40 million in equity, and secured \$310 million in privately placed taxable debt. Loans were to be repaid with toll revenues, and the financing was secured by a first mortgage and security interest in the developer's right, title, and interest in the facility. When the Greenway opened to traffic in September 1995, traffic fell short of projected levels. TRIP II restructured its debt in 1999 and agreed to an extension of the project. In 2001 the Virginia State Corporation Commission (SCC) extended TRIP II's concession period for an additional 20 years to 2056. In 2005 Macquarie Infrastructure Group (MIG) agreed to purchase TRIP II for \$617.5 million.
<b>Other Features</b>	Enabled by 1988 action of Virginia's General Assembly, authorizing private development of toll roads. The maximum toll schedule has been set by the SCC through to the end of 2012. From 2013 through to 2020 tolls can escalate annually at the higher of CPI plus 1%, real GDP, or 2.8% per annum. Post-2020 tolls are set by the SCC on application. One of first U.S. projects to embody the basic concepts of project revenue financing. The Greenway is the first toll road in greater Washington, D.C. to feature variably priced tolls.

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**Texas IH-635 / LBJ Freeway**

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<b>Item</b>	<b>Description</b>
<b>Ownership</b>	Texas Department of Transportation (TxDOT) is the promoter. A consortium that includes Cintra (LBJ Infrastructure Group) has won the concession.
<b>Operational Details</b>	The project consists of improvements to the existing IH-635 (LBJ Freeway) in the Dallas-Fort Worth metropolitan area and is part of a corridor that is 21 miles long. The scheme is a “managed lane” project. Construction will start in early 2011 and is expected to be completed in 2016.
<b>Type of privatization</b>	Long-term lease of the IH-635 Managed Lanes (DBFMO)
<b>Date of Transaction</b>	June 2010 Financial Close
<b>Valuation</b>	\$2.6 billion
<b>Description of transaction</b>	The transaction was launched May 2005, with Pre qualifications submitted in September 2005, and four teams pre qualified to bid in November 2007. Request for detailed bids was issued in October 2007, with an original bid deadline of March 2008. The bid deadline was extended such that bids were not submitted in January 2009. The preferred bidder (the Cintra team) was selected in February 2009. Commercial close was achieved in September 2009. The ultimate members of the winning team were Cintra Infraestructuras (50%), Meridiam (40%) and Dallas Police & Fire Pension System (10%). This is different to the original structuring of the consortium when the prequalification process began. Financial close was significantly delayed, with close finally achieved in June 2010.
<b>Other Features</b>	The project will be financed with USD600m in PABs, a Transportation Infrastructure Finance and Innovation Act (TIFIA) loan of \$850 million, a \$630 million equity contribution from the winning consortium, and \$520 million from the Texas Department of Transportation. The PABs will be senior debt secured on the project's revenue and the TIFIA loan will have subordinate status unless the project goes into bankruptcy, at which point the TIFIA loan moves up to parity with the senior bonds. Both agencies put a stable outlook on their ratings.

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**Miami Port Tunnel, Florida**

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<b>Item</b>	<b>Description</b>
<b>Ownership</b>	Grantor: Florida Department of Transportation (FDOT). The Concession was granted to: Miami Access Tunnel (ultimate equity was Meridian and Bouygues).
<b>Operational Details</b>	The project is being led by Florida Department of Transportation (FDOT) in partnership with Miami-Dade County and the City of Miami. The DBFMO contract has a 30 year concession period after a maximum of five years for construction and improvement works. The tunnel will connect Watson Island to the Port of Miami-Dade and remove thousands of heavy truck and bus trips a year from downtown Miami streets.
<b>Type of privatization</b>	DBFOM contract for new tunnel
<b>Date of Transaction</b>	Financial close in October 2009
<b>Valuation</b>	\$1 billion
<b>Description of transaction</b>	The transaction was launched in February 2006 and in April 2006 three consortia were short-listed. Bids were submitted in March 2007 and in May 2007 the Miami Access Tunnel Consortium were chosen. This group had proposed the lowest annual maximum availability payment at \$33.23 million. However, the project struggled to close and FDOT cancelled the project in December 2008. However, in April 2009 FDOT reaffirmed its commitment to the deal by agreeing to move forward with the existing procurement process. This change of heart appears, at least in part, to have been triggered the replacement of one of the major equity investors”. Commercial close was achieved by June and financial close in October 2009. The TIFIA debt portion of amounts to around \$340 million and the loan term is 35 years. A total of ten banks provided \$340 million of senior debt with the sponsor, the Miami Access Tunnel consortium, providing \$80 million of equity, with Meridian Infrastructure at 90% and Bouygues at 10%. The gearing ratio is 90:10.
<b>Other Features</b>	FDOT will pay the consortium milestone payments at various stages of project development. FDOT will also provide availability payments to the concessionaire that begin at the completion of construction and will occur annually for 30 years.

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**Trans-Texas Corridor (TTC I-69)**

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<b>Item</b>	<b>Description</b>
<b>Ownership</b>	Texas Department of Transportation (TxDOT) is the promoter. A consortium that includes Zachry of Texas and ACS of Spain has won the concession.
<b>Operational Details</b>	The TTC I-69 is the Texan component of the planned 1,600-mile national highway connecting Mexico, the United States and Canada. The TTC I-69 will be an interstate-quality highway corridor running from the Lower Rio Grande River Valley to I-37 and continuing along the south and east portions of Texas from Corpus Christi through Houston all the way to northeast Texas.
<b>Type of privatization</b>	Comprehensive Development Agreement
<b>Date of Transaction</b>	The winning “partner” was identified in June 2008.
<b>Valuation</b>	Undefined – although the total corridor was said to require \$30 billion.
<b>Description of transaction</b>	In Apr 2006 TxDOT issued an RFQ for the project. In September 2006 two teams were short-listed to receive Request for Detailed Proposals. The two consortia were bidding to enter into a Comprehensive Development Agreement with the state to design, develop, finance, construct and maintain the 600-mile multi-use transportation corridor from Northeast Texas to Mexico. In March 2008 TxDOT received two proposals and in June 2008, the Zachry and ACS team won the contract. In June 2008 it was said they would need up to 18 months to complete the development and financial plans. There has been no announcement since.
<b>Other Features</b>	The contract included the right of first negotiation to perform work on certain projects. All of the planning work completed by the CDA Partner will be done within the constraints spelled out by the Texas Transportation Commission and state law. ACS and Zachry had proposed 7 projects and suggested toll revenues be used to help finance sections of US 77. The \$2.5 billion upgrade of US 77 was proposed to be the first of the projects developed under the TTC. TxDOT stressed that separate facility agreements would be needed if it move forward with the design, construction, financing, maintenance and operation of any specific projects identified within the master plan.

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**I75/I575 Unsolicited Bid in Georgia**

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<b>Item</b>	<b>Description</b>
<b>Ownership</b>	Georgia Department of Transport (GDOT) and a joint venture between Bechtel and Kiewit
<b>Operational Details</b>	The I75 (and I575) north of the I285
<b>Type of privatization</b>	Unsolicited Bid / Developer Service Agreement
<b>Date of Transaction</b>	The agreement was signed in May 2006 and terminated in November 2009
<b>Valuation</b>	\$38.5 million
<b>Description of transaction</b>	<p>In 2003, the Georgia legislature passed a law that allowed for unsolicited proposals to be submitted under what was then known as the Public Private Initiative, or PPI, program. The law allowed private-sector entities to submit proposals for public-sector projects. GDOT in May 2006 announced it has signed its first-ever Public Private Initiative (PPI) contract, a Developer Services Agreement (DSA) with Georgia Transportation Partners (GTP), a joint-venture company formed by Bechtel Infrastructure Corporation and Kiewit Southern Co. The DSA provided the procedural framework for the Georgia DOT and private-partner GTP to examine improvements to the Northwest Corridor. Congestion relief options to be studied under the DSA include a combination of High Occupancy Vehicle, High Occupancy Toll, Express Toll and Truck-Only/ Toll lanes, and a Bus Rapid Transit system. The entire scope of services for the DSA was to be completed no later than July 2009. The approach was for the Department to negotiate a Developers Service contract with the PPI team. This contract would spell out the PPI team's role in the environmental process. After the environmental process was complete, a Design/ Build contract had to be negotiated. If that contract was negotiated to each party's satisfaction, the PPI team would take over the final design of the project and the construction. However, in November 2009 GDOT confirmed that it was canceling all un-solicited P3 Projects and moving ahead with a solicited bidding procurement program. The I75/I575 is the first of those solicited proposals and is already in procurement.</p>
<b>Other Features</b>	Several unsolicited proposals were submitted, including GA316, GA400 and I285/I20, although only I75/I575 was ultimately progressed.

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### Off-Street Garages, Chicago

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<b>Item</b>	<b>Description</b>
<b>Ownership</b>	Morgan Stanley is the concessionaire. It has LAZ parking as its operator. The project sponsor was the Chicago City Council.
<b>Operational Details</b>	The parking system included within the deal is considered to be the largest downtown underground public parking system in the US. It is located under the Grant and Millennium Parks in downtown Chicago, has over of 9,000 spaces and four underground parking garages. The contract is a long-term agreement granting the private operator the exclusive right to operate the Parking System and to collect parking, advertising and retail concession revenue during the term of the agreement.
<b>Type of privatization</b>	99 year concession to maintain, operate and collect revenues from four off street parking garages.
<b>Date of Transaction</b>	Financial close December 2006.
<b>Valuation</b>	The winning team bid \$563 million for the 99 year concession sale and lease. The garages had 2005 income of approximately \$16 million, which equates to earnings multiple of 35 based on the bid price of \$563 million, or 39 based on the bid price plus \$65 million estimate of what was needed to rehabilitate the East Monroe Street garage.
<b>Description of transaction</b>	<p>The conditions of the sale were that the concessionaire must carry out certain improvements, particularly the rehabilitation of the East Monroe Street garage within five years. The city's estimate of the cost is USD65m. However, the actual cost was determined by the concessionaire and bidders were not asked to specify this.</p> <p>Funding Sources were all equity.</p>
<b>Other Features</b>	<p>The City used the proceeds from the sale as follows:</p> <ul style="list-style-type: none"><li>• \$122 million is for Chicago park improvements.</li><li>• \$120 million in a reserve to generate income to replace the Park District's annual parking fee income of \$5 million.</li><li>• \$278 million to pay off all debt associated with the garages.</li><li>• \$35 million to rebuild Daley Bicentennial Park when the East Monroe Street garage is re-built by the lessee.</li><li>• \$8 million is for banking, legal, and transaction fees.</li></ul>

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### On-Street Metered Spaces, Chicago

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<b>Item</b>	<b>Description</b>
<b>Ownership</b>	Morgan Stanley Infrastructure (MSI) is the concessionaire. It has LAZ as its operator. The project sponsor was the Chicago City Council.
<b>Operational Details</b>	Chicago's metered parking system comprises around 36,000 on-street metered parking spaces, many in the central business district. This project involved the replacement of most of the existing mechanical parking meters with electronic ones and then their maintenance and operation.
<b>Type of privatization</b>	75 year concession to maintain, operate and collect revenues from parking meters.
<b>Date of Transaction</b>	Financial close February 2009.
<b>Valuation</b>	The winning team bid \$1.15 billion for the 75 year concession.
<b>Description of transaction</b>	The conditions of sale were the city set the future parking rates and the concessionaire had to update and maintain the parking meter stock. There were some built-in protections for concession revenue related to actions by the City. The concessionaire was to operate and maintain the parking system and collect the revenues but the City would collect parking fines. The Concession Agreement included provisions for compensation to the Concessionaire for changes in the number of spaces, hours of operation, and parking rates. Funding Sources were originally all equity. However, in May 2010 the concessionaire closed a long-tenor, forward starting interest rate swap (IRS). Five banks acted as swap providers.
<b>Other Features</b>	The project has had numerous opponents. Firstly, not long after financial close, Chicago's Inspector General's Office released a report criticizing the deal, claiming Mayor Richard Daley and aldermen had moved too quickly in approving a \$1.15 billion contract with MSI. Then, in August 2008, a lawsuit was filed against the deal by tax payer organization, which a Cook County Circuit Court later in 2008 permitted to proceed. In May 2010 the case had still not been heard in court. The scheme also initially attracted a lot of bad press related to the period immediately following the take over by the private contractor, although that no longer appears to be an issue.

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**Las Vegas Monorail, Nevada**

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<b>Item</b>	<b>Description</b>
<b>Ownership</b>	The original scheme developed by two hotels. The current owner is the Las Vegas Monorail Company (LVMC), a not-for-profit company that acquired the original Monorail system. It is governed by its board of directors, appointed by the governor of Nevada. The project sponsors are the State of Nevada Department of Business and Industry, Clark County (franchise and ROW) and the Nevada Department of Transportation (ROW).
<b>Operational Details</b>	The number of passengers averaged 22,800 per day in 2008, with a maximum of 70,000 passengers a day during exhibitions. The system is 3.9 miles and has 7 stations/stops. It operates on a frequency of between 4 and 12 minutes from 7:00 A.M. to 2:00 A.M Monday to Thursday and 7:00 A.M. to 3:00 A.M Friday to Sunday. The Fares are \$5 (Single), \$14 (One day pass) and \$30 (Three day pass). Expansion of the Monorail to McCarran International Airport is under consideration.
<b>Type of privatization</b>	Originally there was a management contract for construction, operation and maintenance of the system. The Project Delivery / Contract Method was modified to a BOT/ DBOM when the system was extended.
<b>Date of Transaction</b>	The current LVMC franchise was signed in 2000.
<b>Valuation</b>	Cost of LVMC expansion project was \$650 million.
<b>Description of transaction</b>	The Monorail was originally a joint venture between MGM Grand and Bally's Hotel, creating a 1 mile system in 1993. In 2000, the non-profit public benefit corporation LVMC acquired the Monorail under a 50-year franchise. A key objective in 2000 was to expand the monorail using private sector funds. The funding source was Tax exempt revenue bonds (backed by fares and advertising). The limited liability company's rights to the initial monorail project, granted under franchise from Clark County, were granted to LVMC under the new franchise. The expanded Monorail suffered mechanical on reopening in 2004 although it now operates reliably.
<b>Other Features</b>	In January 2010 the Las Vegas Monorail filed for Chapter 11 Bankruptcy Protection. The filing is not expected to affect system operations or impact the Monorail's hours of operation or service to its customers.

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### Boston Rail Operating Franchise

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<b>Item</b>	<b>Description</b>
<b>Ownership</b>	Massachusetts Bay Transit Authority (MBTA) is the promoter of the operating franchise. The Massachusetts Bay Commuter Railroad Company (MBCRC) is the current franchise holder.
<b>Operational Details</b>	This is a fully integrated train operation for the 13-line urban rail network around Boston (i.e. it includes track maintenance, station management, ticket selling and train operation and control). However, there is no patronage revenue risk with the franchise holder.
<b>Type of privatization</b>	It is a concession, normally for 5 years, although it can be extended.
<b>Date of Transaction</b>	The current concession was awarded in July 2003 to the Massachusetts Bay Commuter Railroad Company (MBCR). The MBCR contract originally expired in July 2008 but included an additional five-year option. This option was taken, with the franchise was originally extended by three years to July 2011 and then later by another two years to July 2013.
<b>Valuation</b>	It was a fixed price franchise committed for length of concession although MBTA took risk on fuel costs. The value was around \$1 billion.
<b>Description of transaction</b>	The payments to MBCR are made based on performance and any major capital development, e.g. new rolling stock or stations, would involve additional payments to MBCR.
<b>Other Features</b>	The basic length concession included the opportunity to extend the franchise if it was progressing well. The concession required the franchise bidder to demonstrate how they would deal with extreme winter weather but the public sector set aside additional funding for the annual snow plan (i.e., the cost risk of severe weather was retained by the public sector). The franchise bid had to include discrete pricing for line extensions and any major changes planned within the period of the concession. The concession followed other State contracts in requiring a minimum percentage of the contract to be provided by “disadvantaged suppliers” which was 11.5% by value.

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### Denver FasTracks

<b>Item</b>	<b>Description</b>
<b>Ownership</b>	The project promoter is Denver's Regional Transportation District (RTD). The winning consortium for the Eagle P3 project, known as Denver Transit Partners (DTP), comprises Fluor, Macquarie, Balfour Beatty, ACI, Ames Construction, Hyundai-Rotem and HDR. In June 2010 the deal had 60 days to reach financial close.
<b>Operational Details</b>	FasTracks was approved in 2004 and was intended to expand and improve the Regional Transportation District's (RTD) rail and light rail connections. The RTD now proposed to bridge a projected funding shortfall of over \$0.5m using alternative financing strategies, including P3s. The P3 consists of the East Corridor, Gold Line, Commuter Rail Maintenance Facility and an initial segment of the Northwest Rail Corridor. The East Corridor is a 22.8-mile commuter corridor from Denver Union Station to Denver International Airport. The Gold Line is an 11.2-mile commuter corridor connecting Denver Union Station to Ward Road. The Commuter Rail Maintenance Facility will serve the four FasTracks commuter rail corridors. The portion of Northwest Rail included in the P3 includes shared tracks with Gold Line plus an additional two miles north to the South Westminster Station. Phase I includes property acquisition, construction of the East Corridor, construction of the Maintenance Facility and control centre, purchase of Electric Multiple Unit rail vehicles and the electrical systems at Denver Union Station. Phase II includes the Gold Line and the short segment of Northwest Rail. Phase II is scheduled to begin following the award of a Full Funding Grant Agreement (FFGA) by the Federal Transit Administration in 2011.
<b>Type of privatization</b>	DBOM for 40 years.
<b>Date of Transaction</b>	The winning consortium was selected in June 2010 and has 60 days to reach financial close.
<b>Valuation</b>	\$2.085 billion – the RTD estimate was \$2.3 billion.
<b>Description of transaction</b>	The consortium will operate and maintain the project for 40 years after completion in return for annual performance-based payments.
<b>Other Features</b>	The deal is using a private activity bond (PAB) debt financing solution. The tax-exempt PABs will have a 30-year maturity and be callable after 10 years. The issue amount will be between \$400 million and \$500 million.

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**Seagirt Terminal, Baltimore**

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<b>Item</b>	<b>Description</b>
<b>Ownership</b>	The terminal is owned by Maryland Transportation Authority (MdTA). Ports America Baltimore, Highstar's existing operator at the port, is the parent company of Ports America Chesapeake (PAC), the project company.
<b>Operational Details</b>	Seagirt is the largest facility in Baltimore Harbor and commenced operations in the 1990. It has a current minimum annual capacity of 1.0 million TEUs across its three berths and in 2008, handled 500,000 TEUs. The concessionaire will expand (building an additional 50 ft berth) and operate the Seagirt Marine Terminal in Baltimore as part of a 50-year lease. The concessionaire will benefit from a revenue sharing structure, above a certain level of container volume use at the facility. The Port of Baltimore has been running for over 300 years. In 2008 the port handled about 40 million tons.
<b>Type of privatization</b>	Long term lease of existing asset; includes expansion plans.
<b>Date of Transaction</b>	January 2010
<b>Valuation</b>	\$334 million
<b>Description of transaction</b>	The transaction was launched on April 20, 2009. On July 1, 2009, the pre-qualified proponents were Ports America (Ports America Baltimore), Ceres and Alinda Capital Partners LLC. The preferred proponent, Ports America (Ports America Baltimore) was chosen on November 20, 2009. The financial close was reached on January 7, 2010. The equity and Debt split was: Equity: \$75 million, debt: \$259 million.
<b>Other Features</b>	MdTA plans to reinvest funds from this concession as part of a capital program that will allow major highway related projects to proceed including upgrades to I-95, US 40 Hatem Bridge and US 50/301 Bay Bridge. Under the terms of the deal, PAC will fund construction of a 50-foot deep berth at the Seagirt Marine Terminal and the purchase of four new cranes. It will fund a repayment to MdTA for investment in Seagirt, as well as provide ongoing revenues for administrative and other port purposes. The cost of building the new berth is put at slightly over \$100 million. The upfront payment is thought to be between \$200 million and \$250 million. The anticipated capital investment in projects at the port over the 50-year lease is \$500 million.

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**Port of Oakland Outer Harbor**

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<b>Item</b>	<b>Description</b>
<b>Ownership</b>	The Port of Oakland owns the five container berths. Ports America Outer Harbor Terminal, LLC is a partnership with Terminal Investments Ltd, an affiliate of Mediterranean Shipping Co and Ports America, parent company Highstar.
<b>Operational Details</b>	The Port of Oakland was established in 1927 and ranks as the 4 <sup>th</sup> busiest container port in the USA. The port has 20 deepwater berths, 35 container cranes, 10 container terminals and 2 intermodal rail facilities, which handle over 2 million containers a year. The long-term concession agreement includes the operation and improvement of berths 20 through 24. The area accounts for approximately 4,400 feet of berth with about 160 acres of storage space. Additionally, the concession agreement allows for the opportunity to acquire the adjacent berths 25 and 26 once the current use agreement for that area expires (as early as June 30, 2013). The combined areas (Berths 20-26) are the equivalent of five to six container ships in a row. The first phase of Ports America Oakland's operational plan includes the investment of up to \$150 million. During the life of its operational stewardship Ports America Oakland plans to invest significant additional capital to improve the competitiveness of the port for the benefit of its many served communities and customers.
<b>Type of privatization</b>	50 year lease
<b>Date of Transaction</b>	March 2009, effective January 2010
<b>Valuation</b>	\$700 million
<b>Description of transaction</b>	Ports America Oakland is paying a \$60 million up front fee to the Port of Oakland and an annual rent of at least \$19.5 million, with the figure rising each year. The deal was done within 10 months from RFP.
<b>Other Features</b>	Environmental benefits were considered in the bid. Port America Oakland estimate that when their build out is completed, emissions per TEU could be reduced by as much as 90% due to electric stacking cranes rather than diesel, no truck idling and fewer miles driven within the yard, ship to shore power and truck appointments.

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## **Appendix E**

### **Emerging Domestic Issues Influencing U.S. Airport Privatization**

Appendix E provides an analysis of the national trends and issues that influence the attractiveness of the Airport Privatization Pilot Program (APPP) and airport privatization in general since the creation of the APPP in 1996 and for the near future. Appendix E.1 provides a list of acronyms for this chapter.

#### **E.1 Introduction**

Since 1996, only a handful of U.S. airports have applied for the APPP. It was not until 2006 -- 10 years after the APPP became law -- that an owner of a large hub airport<sup>1</sup> applied for the one slot of the five dedicated to large hubs. As of September 2011, the program's 5th slot remains open for any U.S. airport other than a large hub.

Unlike international airports, a major distinguishing factor for U.S. airports has been the existence of national policies that provide comparatively robust infrastructure support for the nation's airports, including:

- The FAA's *Airport Improvement Program (AIP)* that provides federal capital grants to support airport infrastructure, including entitlement grants (determined by formulas based on passenger, cargo, and general aviation activity levels) and discretionary grants (allocated on the basis of specific set-asides and the national priority ranking system);
- *Passenger Facility Charges (PFCs)*, a federal authorization that permits airports to charge passengers for the use of airport infrastructure outside of the contractual use and lease agreement relationship between airport and airlines;
- *Access to Tax-Exempt Debt* that lowers the cost of borrowing for airports seeking to raise money in the capital markets.

In addition, a number of states offer supplemental airport grant programs to assist airports to fund the local match to federal grants and to help finance non-AIP funded improvements in recognition of the strong economic development benefits provided by airports to states and communities. Some states also offer infrastructure bank loans with low-cost borrowing to help airports fund capital improvements.

Therefore, unlike in Australia or the United Kingdom, where airports were privatized in part because of the unwillingness of governments to assume capital funding obligations, in the U.S. there has been a strong national funding commitment, together with modest state contributions, to help states and localities develop their airports. In part because of these federal and state grant programs and policies, very few U.S. airport owners have chosen to build a private-use airport or to participate in the APPP.

As a practical matter, the decision to participate in the APPP, complete with its rules, has to be

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<sup>1</sup> A large hub airport is defined by the FAA as any U.S. airport that accounts for 1% or more of annual boarding passengers.

weighed against the support normally available to U.S. airports through the traditional FAA program, complete with its rules. In fact, communities seeking to participate in the APPP retain the ability to receive some of the public support available to airports under the traditional FAA program. This support includes AIP funding eligibility (albeit at a reduced level for discretionary projects) and PFC authority. However, the advantages do not extend to the subsidies available to public issuers of tax-exempt bonds.

It is important to reiterate that the lack of alternative options for funding airport development may not be the only reason a community would choose to participate in the APPP. Other reasons could include the desire to secure an upfront payment for the long-term lease of the airport, and/or delegating the responsibility to run the airport to an experienced private operator, which the owner may think can offer superior management compared to the existing public sector management structure. A more complete discussion of the motivations for privatization is found in Chapter 1.1. In addition, management contracts and developer/project financing (often referred to as “partial privatization”) is comprehensively explained in Chapter 5.

## **E.2 Airports and Capital Development: 1996-2011**

One way of understanding the past, current, and future decision-making of airport owners with the APPP is to examine how the relative attractiveness of FAA programs has changed over time. Since the APPP was created, the assistance and options available for airport capital development have changed considerably -- first increasing, then leveling off, and now in 2011 appearing to continue a period of steady decline (especially if the value of inflation is included). Future considerations by airport owners will continue to be made in the context of the available capital support and regulatory structure of the traditional FAA program versus the options available under the APPP.

### **E.2.1 U.S. Airport Policy: 1996-AIR 21 (2000)**

In Federal Fiscal Year (FY) 1996,<sup>2</sup> the year the APPP was created, the FAA spent \$1.4 billion on airport capital grants under its AIP; airports collected \$1.1 billion in federally authorized, locally assessed PFCs; and airports issued \$4.1 billion in tax-exempt bonds, backed by pledges to repay the principle and interest mainly from airports’ aeronautical and non-aeronautical revenues as well as revenue collected from PFCs.<sup>3</sup>

In 1996, as today, three types of bonds were available to finance airport projects that have different tax treatments:<sup>4</sup> (1) interest on “Taxable Bonds” is fully taxable, (2) interest on “Private-Activity Bonds” or “AMT Bonds,” although generally excluded from taxable income of the holder, is an item of tax preference under the alternative minimum tax provisions of the Section 142 of the Internal Revenue Code of 1986 (as amended) and the Treasury Regulations, and (3) interest on “Governmental Bonds” or “non-AMT Bonds” as defined in Section 141 of the Code is fully free of taxation for bondholders. AMT Bonds are issued for facilities that will have excessive use by private users (e.g., terminal buildings). Non-AMT Bonds are used for facilities that do not have an excessive level of use by private users (e.g., roadways and sometimes parking and airfield facilities).

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<sup>2</sup> The Federal Fiscal Year ends September 30.

<sup>3</sup> U.S. General Accounting Office, *Airport Financing*, GAO/T-RCED-99-84 (Feb. 10, 1999).

<sup>4</sup> As part of the 2009 American Recovery and Reinvestment Act, a fourth type of bond (“Build America Bonds”) was created on a limited period basis, as described later.



The federal subsidies for AMT and non-AMT bonds result in lower interest costs on long term debt, which provide a comparative advantage for public entities financing infrastructure improvements.

As part of the Federal Aviation Reauthorization Act of 1996, which also created the APPP, policymakers agreed to raise AIP funding authority to \$2.280 billion for FY 1997 and \$2.347 billion for FY1998. At first glance this would appear to be a 64% increase in funding for capital grants.<sup>5</sup> However, pressures to reduce the federal budget deficits during this time and a depleted Airport and Airway Trust Fund (AATF)—which provides the funding for AIP, the FAA Facilities and Equipment (F&E) and other obligations—constrained the FAA budget, resulting in Congress setting an obligation limit of only \$1.46 billion in FY 1997 and \$1.70 billion in FY 1998. The obligation limit is set by congressional appropriators to indicate how much of the authorized money FAA can actually spend for capital accounts such as AIP.<sup>6</sup> The differences between the authorized and appropriated levels, or between what was promised and what was delivered, were \$820 million for FY 1997 and \$647 million for FY 1998. These differences were significant and became a catalyst for future reform.

At the time, U.S. airports estimated that they needed approximately \$10 billion in annual funding for the period between 1997 and 2001, meaning they were well short of the funding necessary for their development needs.<sup>7</sup> While the PFC provided a total of over \$1 billion a year in revenue to the airports, the \$3.00 ceiling (per flight segment for a maximum of \$12.00 on a round-trip itinerary) was not indexed to inflation and had not been increased since it was first assessed in 1991. In this restrictive budget environment, there was also a move by the Clinton Administration to assess if the private sector and alternative finance mechanisms could play a greater role in providing government services, including funding capital infrastructure.<sup>8</sup> As the FAA's 2004 Report to Congress indicated “it was the stated intent of Congress to determine if new investment and capital from the private sector can be attracted through innovative financial arrangements.”<sup>9</sup>

The APPP, which would first be available to airports in 1997, presented a new option for airport owners seeking to develop their airports.

## **E.2.2 AIR 21 (April 2000)**

Notwithstanding the budget challenges, the mid- to late-1990s was a time of strong economic growth and an expanding U.S. aviation market as illustrated on Figure E.1. Passenger enplanements grew 15% between 1996 and 2000, causing concerns within government and the aviation sector that the pace of infrastructure investment was too slow and would prove insufficient to head-off future congestion. These concerns and strong congressional support for infrastructure development led to the passage of the Wendell H. Ford Aviation Investment and Reform Act for the 21<sup>st</sup> Century (AIR 21) in April 2000, which included a number of reforms to AIP and the PFC program that would help spark record new levels of public investments in airports.<sup>10</sup>

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<sup>5</sup> Public Law 104-264.

<sup>6</sup> Congressional Research Service, *Aviation Spending Guarantee Mechanisms*, RL33654 (Mar. 25, 2008).

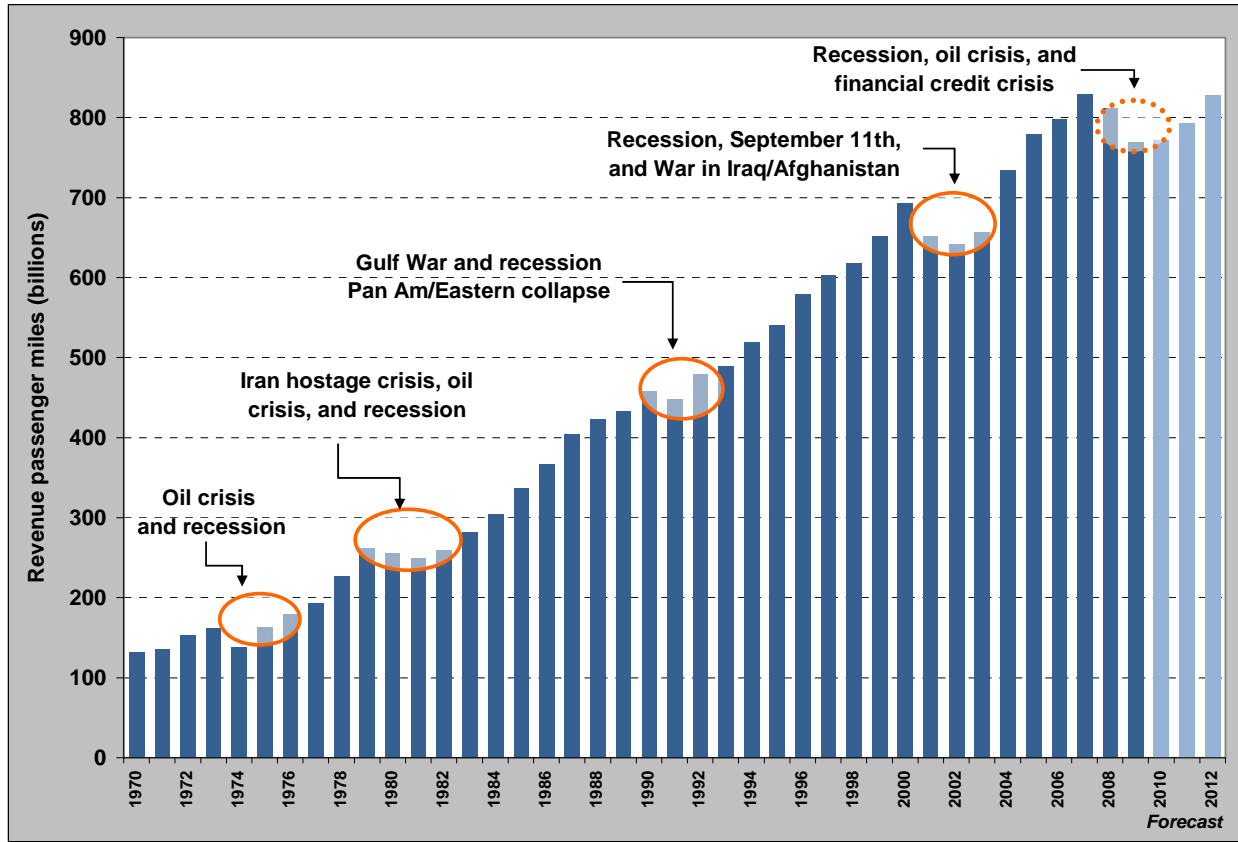
<sup>7</sup> U.S. General Accounting Office, *Airport Financing*, GAO/T-RCED-99-84 (Feb. 10, 1999).

<sup>8</sup> National Partnership for Reinventing Government, *A Brief History* (January 1999).

<sup>9</sup> Federal Aviation Administration, *Report to Congress on the Status of the Airport Privatization Pilot Program, United States Code, Title 49, Section 47134*, at 1 (August 2004).

<sup>10</sup> Public Law 106-181.

Figure E.1. Long-Term Trend in Passengers

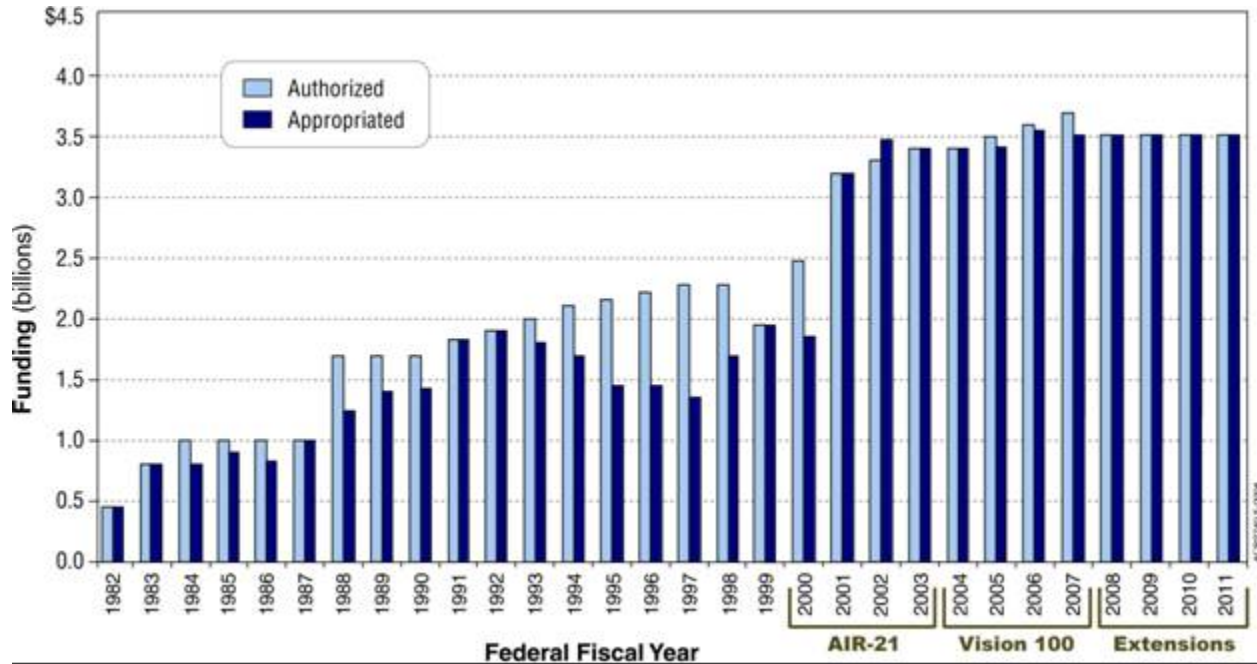


Sources: Air Transport Association, [www.airlines.org](http://www.airlines.org); Federal Aviation Administration, [www.faa.gov](http://www.faa.gov), accessed June 2010.

AIR 21 increased the AIP authorization from \$2.5 billion in 2000 to \$3.2 billion in 2001, a 29% increase. The increase was actually 68% if the actual appropriated levels of \$1.896 billion (FY 2000) and \$3.199 billion (FY 2001) are compared. For FY 2002 and FY 2003, the AIP level was increased by an additional \$100 million each year as illustrated on Figure E.2. Accompanying this increase were a series of congressional budget rules, which had the effect of making it more difficult for congressional appropriators to set the obligation limit lower than the authorization and thereby not fully appropriate to the AIR 21 authorized levels (as had happened under the 1996 FAA Authorization). Since its passage, the budget rules have largely worked as the authors of AIR 21 intended as AIP appropriated levels have closely tracked the authorized levels. This is especially important for airports at the non hub level and below, which rely on AIP for a larger share of their capital development program. Under FAA formulas, any appropriation, below \$3.2 billion results in a significant reduction of an airport’s entitlement.<sup>11</sup>

<sup>11</sup> Non hubs are airports that have at least 10,000 annual boards but below 0.05% of the system’s total boardings (see [http://www.faa.gov/airports/planning\\_capacity/passenger\\_allcargo\\_stats/categories/](http://www.faa.gov/airports/planning_capacity/passenger_allcargo_stats/categories/) for additional information).

Figure E.2. AIP Funding Levels



Source: Federal Aviation Administration.

While AIP is arguably important for all airports, busier airports (with traffic levels above those of non hubs) have a larger set of available options. In addition to the aeronautical and non-aeronautical revenue, the largest source of revenue is normally the revenue collected from PFCs. AIR 21, attempting to maintain a balanced program of AIP (smaller airports) and PFC (larger airports), increased the PFC ceiling to \$4.50, a 50% increase. This increase also helped smaller airports. For airports that are medium and large hubs, any increase above \$3.00 now required that the airport turn back 75% its AIP entitlements to the FAA to be used at smaller commercial service and general airports (this was an increase from the 50% turn back required from these airports when they assessed a \$3.00 PFC). Since the passage of AIR 21, the ceiling for the PFC has remained at \$4.50.

Starting in 2001, therefore, the traditional FAA program became more attractive as U.S. airports could tap record levels of AIP and a higher PFC, together with federal tax subsidies available with tax-exempt private activity and government bonds to help pay for airport development. Seen in that light, it is not surprising that only one non hub airport –Stewart International Airport in 2000—had both applied and had been approved under the APPP (several other smaller airports had withdrawn their preliminary applications to participate in the program).

### E.2.3 AIR 21 to 2011: Status Quo and ARRA

Since the passage of AIR 21, policymakers have passed only one multi-year reauthorization of the FAA and its programs, Vision 100—Century of Aviation Reauthorization Act enacted on December 12, 2003.<sup>12</sup> In Vision 100, policymakers did not increase the \$4.50 PFC ceiling and took an incremental approach to funding AIP, building off AIR 21. The authorized levels for AIP were

<sup>12</sup> Public Law 108-176.

increased \$100 million per year from AIR 21 to \$3.4 billion in FY 2004 through to \$3.7 billion in FY2007. The appropriations for AIP started at \$3.294 billion in FY 2004, \$3.472 billion in FY 2005 and \$3.515 billion for FY 2006 and FY 2007. The four-year authority for Vision 100 expired on September 30, 2007. Policymakers, as part of AIR 21, also increased the access of APPP airports to AIP discretionary grants, increasing their eligibility from 40% of project costs (as it was under the initial program) to 70%. This increase, enacted during the Bush Administration, previewed more aggressive pro-APPP recommendations to come in 2007.

Since the end of FY 2007, policymakers have been unable to agree on a multi-year FAA reauthorization; instead, the president has signed into law over 20 consecutive FAA extensions of authority. For FY 2005 through FY 2011, the obligation ceiling for the FAA AIP authorization held steady at \$3.515 billion or \$185 million less than the last authorized level of \$3.7 billion.

The one exception to the status quo oriented federal airport approach since AIR 21 has been the American Recovery and Reinvestment Act (ARRA) passed by policymakers in February 2009 amid the greatest economic downturn since the Great Depression.<sup>13</sup> Designed to help stimulate the economy by investing in infrastructure and putting people to work, ARRA was a one-time investment that, while significant in the short-term, is unlikely to definitively change airport owners' calculations about whether or not the traditional airport capital development program fully addresses their needs.

Under ARRA, the FAA made available an additional \$1.1 billion in discretionary support for AIP-eligible capital development projects with a 100% federal share (normally projects require a local contribution of between 5% and 25% depending on airport size and annual appropriations language). This one-time infusion of AIP support did not come as it traditionally does from the AATF, but from discretionary government spending (or taxpayers). Any grant an airport received under ARRA was also over and above the annual entitlements or other discretionary grants that airports received for eligible AIP projects.

ARRA did include two temporary bond measures, which have been important to airports for 2009 and 2010 and could be significant if they are included as permanent financing options. For private-activity bonds, traditionally the largest volume of airport bonds issued (which have their interest subject to the alternative minimum tax), policymakers provided a "tax holiday," meaning any bonds issued in calendar year 2009 or 2010 would be classified as non-AMT Bonds and fully tax-exempt (including exclusion from the alternative minimum tax). This provision reduced the interest rate required to sell AMT bonds up to 80 basis points (0.80%), saving issuers significant future year interest costs and potentially increasing their funding capacity.

As part of ARRA, policymakers also created a new Build America Bonds (BABs) program, which provides a new option for issuers whose bonds would otherwise be eligible as fully tax-exempt. Instead of the traditional governmental bonds, which appeal solely to those taxpayers looking for the benefit of tax-free interest, BABs give the bond issuers the option to receive a subsidy equal to 35% of the interest paid on the bonds. This effectively provided a higher interest rate for the buyer but not for the seller. Like the AMT "tax holiday," BABs saved issuers millions of dollars of interest costs and helped to stimulate the public finance market.

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<sup>13</sup> Public Law 111-5.

### E.3 FAA Funding Programs for U.S. Airports

Over the last 15 years, U.S. airports have taken advantage of a comparatively strong national policy of developing airports, both through FAA capital grants and by receiving authorization to collect up to \$4.50 PFCs from airport passengers. For example, in 2009:

- AIP provided \$3.515 billion
- ARRA resulted in AIP-eligible grants of \$1.098 billion
- PFC programs collections totaled \$2.521 billion
- Airports issued nearly \$7 billion in airport tax-exempt bonds (\$6.978 billion, estimate provided courtesy of Airports Council International-North America).

By any measure, U.S. policy continues to provide a strong foundation of support for U.S. airports. Having said that, AIP and PFCs are very different funding sources and their differences are important for each airport's calculations about the APPP.

AIP is a cross-subsidized program for the airport industry. The taxes collected to support AIP are assessed on air travelers, shippers, and airlines with the majority collected on journeys from the nation's busiest airports. For example in 2009, 64% of passengers originated at the top 35 U.S. airports and 92% originated at the top 100.<sup>14</sup> The taxes collected flow back to the FAA and are redistributed accordingly to statute, regulation, and policy to eligible airports. By contrast, PFCs are collected on the airline ticket (for which air carriers receive \$0.11 of each PFC) and stay at the airport for federally authorized projects. In this way, the federal program benefits small and large airports as part of a national system of airports.

As an example of how these federal programs affect different airports, below is a summary of the AIP entitlement grants and PFC revenues for the largest U.S. airport (in terms of passengers) and one of the smallest in 2010.

- Hartsfield-Jackson Atlanta International Airport (ATL), the number one ranked U.S. airport in passenger enplanements, will receive \$6.5 million for its AIP entitlement from the FAA. With just over 42 million annual enplanements, the airport receives approximately \$0.15 per enplaned passenger for its eligible capital development projects. The AIP statutory formula provides a maximum of a \$26.0 million annual entitlement to the airport. As cited, for a large or medium hub airport such as ATL, when it increases its PFC above \$3.00 it must return 75% of its annual entitlement (or \$19.5 million) to the FAA, leaving it with \$6.5 million.
- Under the PFC program, ATL received approximately \$175 million in 2009, reflecting its passenger enplanements and its authorized collection of a \$4.50 PFC. Even with losing \$19.5 million in its entitlement due to its imposition of the \$4.50 PFC, the airport collects a net increase of more than \$150 million a year. Leveraging a significant portion of those monies over two or three decades can potentially provide billions of dollars in upfront capital development support.

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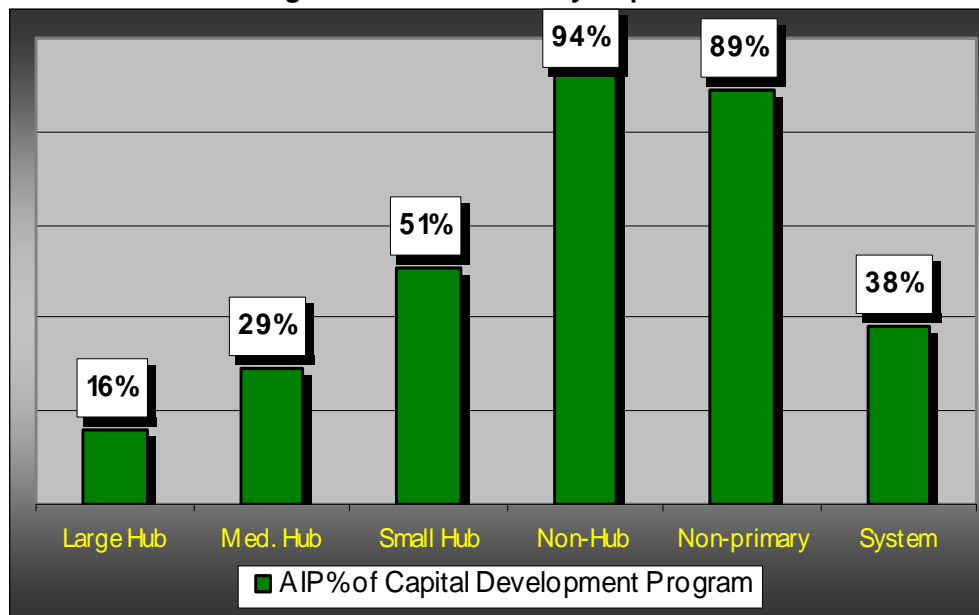
<sup>14</sup> U.S. Department of Transportation, Federal Aviation Administration, Aviation Policy and Plans, *FAA Aerospace Forecast Fiscal Years 2010 to 2030*, March 2010.

- Kansas' Garden City Regional Airport is the 388<sup>th</sup> busiest commercial service airport in the U.S. in terms of passengers. With approximately 10,000 passenger enplanements, the airport receives \$1.0 million for its AIP entitlement, a total of approximately \$100 per passenger for capital development, or approximately 600 times the per passenger support Atlanta receives. Note that these numbers do not include FAA discretionary dollars that either airport may receive in any one year, but it is a reflection of the FAA's annual support for these types of airports.

Garden City does not collect a PFC from its passengers, which would total only a maximum of approximately \$45,000 if it were imposed. Furthermore, by potentially raising the cost of air travel to a small airport, the PFC could deter carriers from locating or expanding air service at the regional airport.

In a 2005 study, FAA found a great variation in airports' reliance on AIP for their capital development programs. According to the study, including entitlements and discretionary grants, large hub airports (such as Atlanta) relied on AIP for 16% of their programs, medium hubs 29%, small hubs 51% and non hubs 94% (including Garden City).<sup>15</sup> Assuming that policymakers' are right in their decisions that a system of commercial service and general aviation airports are worth supporting, the data lend support to the FAA's belief that AIP serves the interests of all airports well.

Figure E.3. Role of AIP by Airport Size

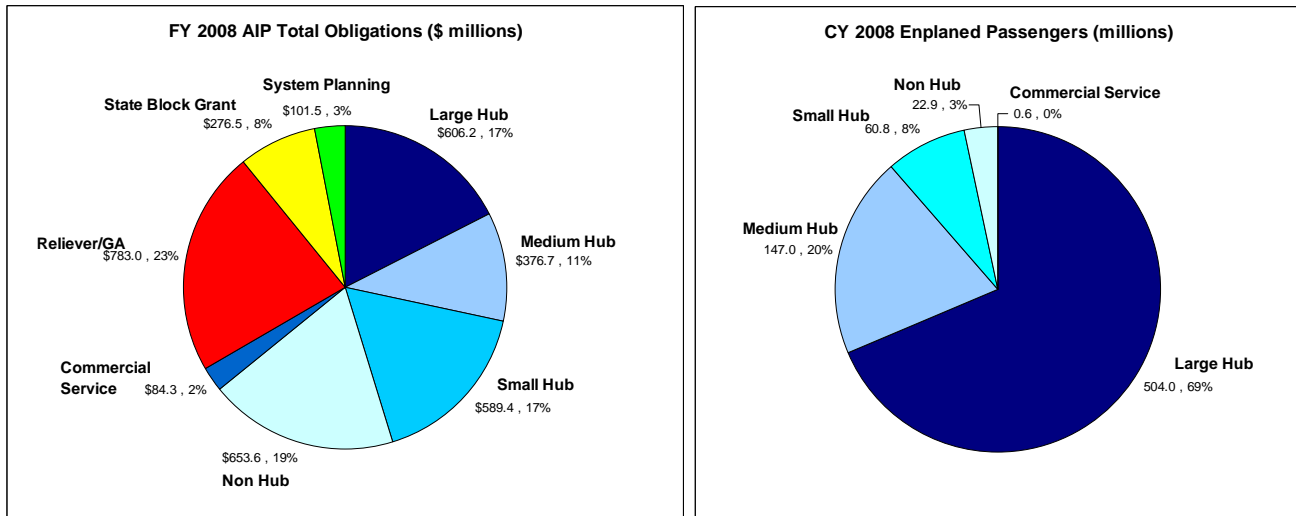


Source: FAA, "Airports Data Package for Stakeholders," September 2, 2005.

As illustrated in Figure E.4, while the large hubs accounted for 69% of enplaned passengers in 2008, they received only 17% of the AIP grants in that year.

<sup>15</sup> FAA, *Airport Data Package for Stakeholders*, September 2, 2005.

**Figure E.4. 2008 AIP Funding Versus Enplaned Passengers**



Sources: FY 2008 AIP Total Obligations: FAA, “Airport Improvement Program, Fiscal Year 2008 Report to Congress, 25th Annual Report of Accomplishments,” April 2010.  
CY 2008 Enplaned Passengers, FAA, “Primary and Non-primary Commercial Service Airports (by Rank Order),” December 18, 2009.

The data also demonstrate an important reality for airport owners: airports situated in a strong market with growing passenger levels can generate significant amounts of revenue from PFCs and from aeronautical and non-aeronautical sources. These dollars can be leveraged for capital development and their rate-setting can effectively recover the costs necessary to maintain and operate the airport. At the same time, the airport’s strong market and its diverse and growing revenue streams make it attractive to potential private investors if the rules set for an acquisition under the APPP are suitable. Assuming there are APPP slots available, the effective choice for an airport owner with regard to funding capital development is between the traditional FAA program and the APPP. For airports in weaker aviation markets with unreliable revenue streams, the potential valuation of the airport is lower. In this situation, unless the airport’s poor market position is a reflection of mismanagement, and therefore unrealized potential, the APPP is not an effective option.

### E.3.1 The Value of the Federal Capital Support in 2010

FAA’s management and stakeholders have lived through a period of continuing uncertainty due to the extensions of AIP authority from the end of FY 2007 through the end of FY 2011. As a result, airports have been unable to plan on either what the overall level of capital funding support will be or how much support will be available from charging PFCs. At the same time, the future of the APPP is uncertain as well, vividly demonstrated by the divergent approaches reforms proposed over the last four years.

One effect of policymakers not agreeing on a long-term bill and not updating either the authorized level for AIP or the PFC ceiling is that the value of the federal capital program has declined for all airports. ACI-NA and the American Association of Airport Executives (AAAE) have computed the real value of the AIP funding level and the PFC by applying the Means Construction Cost Index (Means CCI) to the value of AIP since 2000 and the PFC since the introduction of the \$3.00 PFC in

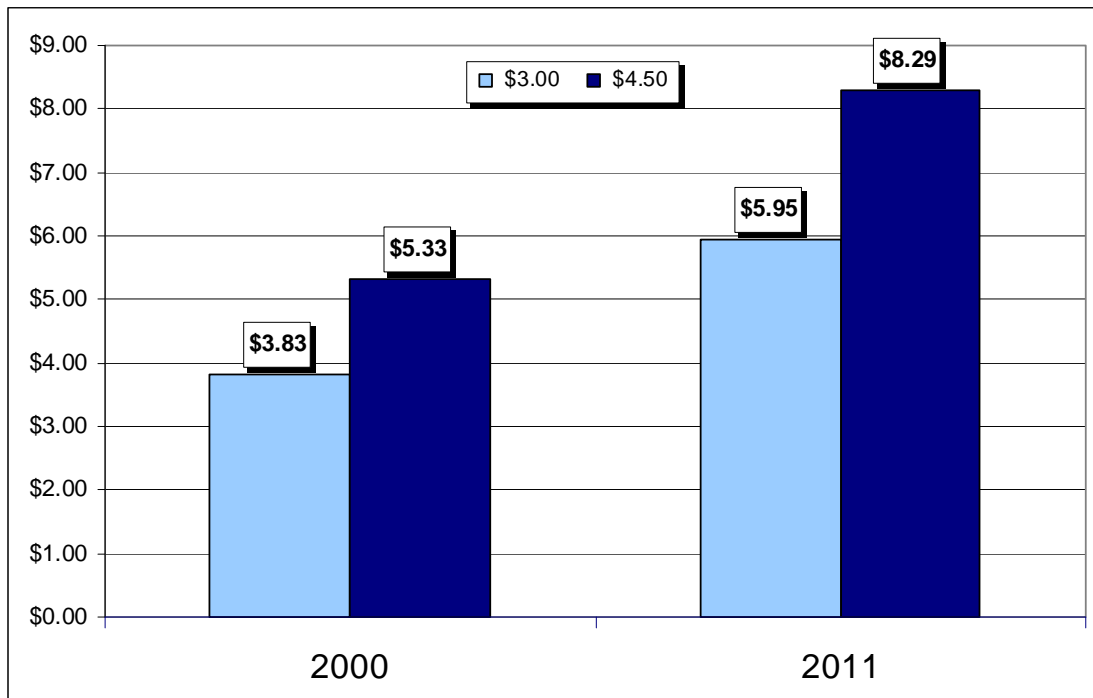
1991 and the \$4.50 PFC in 2001.

For AIP, over the last decade, the real value of the program's overall appropriation is close to the actual value. Over the last five years, however, two trends have eroded a portion of the value. First, policymakers have appropriated less than the authorized level, although not to the degree of FY 1997 and FY 1998. Second, in the absence of a multi-year authorization, policymakers have not increased the AIP authorized funding levels. It should be noted, however, that because much of AIP is distributed according to formula, the amount any one airport receives in entitlement funding is unlikely to change significantly even with an overall increase.

In contrast, the decline in the real value of PFCs is significant. The \$3.00 PFC, which was originally authorized in 1990, is worth \$1.54 in 2010 construction dollars. The additional \$1.50 that became available in 2001 (from increasing the rate from \$3.00 to \$4.50) is worth \$0.98 in 2010. The total value of a \$4.50 PFC is therefore \$2.52 in 2010 dollars.

Viewed another way, if the value of the \$3.00 PFC and the additional \$1.50 increment had been adjusted for construction cost inflation, they would be worth \$5.95 and \$2.39. Taken together a fully adjusted \$4.50 PFC today would be worth \$8.29 in 2011. This higher PFC level would provide the airport industry with billions of dollars in additional funding capacity.

**Figure E.5. PFC Values Adjusted for Inflation for 2000 and 2011**



Note: 2000 and 2011 estimates adjusted based Means' Construction Cost Index.

### **E.3.2 The Future Airport Program and Budget Politics**

While AIP, PFCs, and tax subsidies ultimately all depend on the actions of policymakers, AIP and tax subsidies each have budgetary implications—AIP on the spending side and the tax subsidies on the revenue side. PFCs in contrast are federally authorized, locally generated revenue that have no



impact on the federal budget (although an increase may result in an additional transfer of AIP money from large to small airports).

AIP and tax subsidies must compete with other priorities in the federal budget. While AIP is funded by the AATF, which also funds the Facilities & Equipment (F&E) account and a portion of the operations and research accounts, the FAA's entire budget relies on taxpayers who make up the difference between the FAA budget and available AATF revenues. In recent years, the AATF's uncommitted balance—the portion left over after the FAA pays all of its obligations – has stood around \$1 billion, which is not enough even to operate the FAA for one month.<sup>16</sup>

Consistently over the last decade, FAA projections of tax revenue flowing into the AATF have been overly optimistic; a product of past projections of higher than realized passenger traffic and fares, two of the most important variables determining the level of revenue the FAA collects. The pressures on the AATF are likely to continue, and possibly increase, in the future. Revenues continue to be constrained by lower traffic levels and by air carriers increasingly “unbundling” their fares by charging separately for checking baggage, in-flight services, seat selection, etc., which currently are not taxed and therefore results in lower ticket tax revenue.<sup>17</sup> Spending is projected to increase as the FAA has pledged investments of billions of dollars in NextGen, its program to modernize the nation's air traffic control system and must continue to hire new air traffic controllers to support its operation of the air traffic control system.

To compensate for the difference between declining revenues and increases in spending, taxpayers have been asked to make up the difference with growing contributions to the overall FAA budget. In the last three years, taxpayer contributions have ranged between 25% and well over 30%, well above that of previous years.. Whether or not these growing taxpayer contributions are sustainable into the future is uncertain for a number of reasons.

- The record federal budget deficits and national debt have put pressure on policymakers to hold the line on spending. An acrimonious political battle that took the country to the brink of default in mid-2011 resulted in an unprecedented debt agreement. The congressional committee created by the deficit-reduction law is charged with finding at least \$1.2 trillion in additional savings over the next 10 years. Transportation funding is likely to be one of the targets of this so-called ‘supercommittee.’
- Reflecting this pressure, in late 2010, The National Commission on Fiscal Responsibility identified the elimination of the tax-exempt status for municipal bonds and curtailing FAA grants for “medium and large-sized airports” as options for addressing spending and tax policy.<sup>18</sup>
- Congress in 2010 enacted pay-as-you-go (PAYGO) budgeting rules that require offsetting spending reductions or tax increases to pay for above current levels. This includes the

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<sup>16</sup> U.S. Government Accountability Office, *Challenges Facing the Department of Transportation and Congress*, GAO-09-435T, at 11 (March 10, 2009).

<sup>17</sup> U.S. Government Accountability Office, *Airport and Airway Trust Fund: Declining Balance Raises Concerns over Ability to Meet Future Demands*, GAO 11-358T at 13 (February 3, 2011)

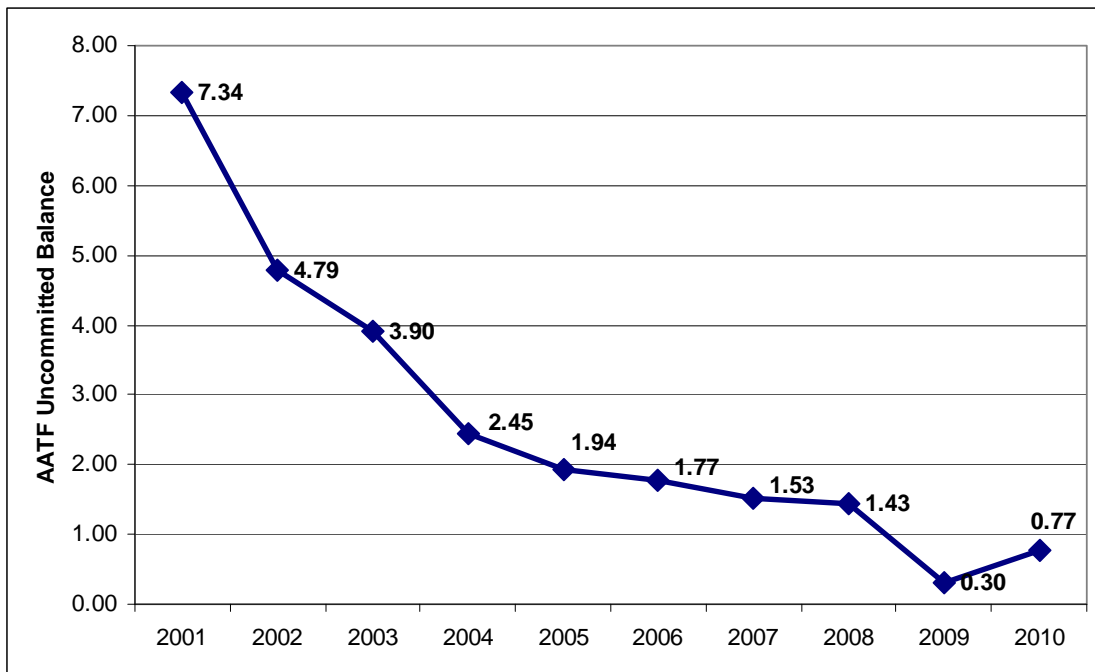
<sup>18</sup> The National Commission on Fiscal Responsibility and Reform, *The Moment of Truth*. See <http://www.fiscalcommission.gov> (accessed March 7, 2011).

taxpayer contributions to FAA programs.<sup>19</sup> Under PAYGO, any increases in spending for transportation require members of Congress to cut spending or increase taxes to pay for it. In 2011, the newly elected House of Representatives replaced PAYGO with a new “cut-as-you-go” (CUTGO) budget rule that eliminated for House legislation the requirement to offset tax reductions, thereby putting even more focus on eliminating future increases in spending. The Senate retained CUTGO.

- With the recent economic recession, the Highway Trust Fund (HTF) and its Mass Transit Account—which fund highway and transit programs—have run deficits in the last three years requiring multibillion dollar infusions of taxpayer money from the same Appropriations subcommittee allocations as the FAA.
- Existing and new transportation programs funded by taxpayer dollars -- Amtrak, high-speed rail, and the new Transportation Investment Generating Economic Recovery (TIGER) or intermodal discretionary grant program -- also fall under the same appropriations allocations, presenting difficult choices to legislators.

With flights, passengers, and yields declining over the past decade, and with a deliberate policy of spending down the AATF, the uncommitted balance is at a very low level, providing few resources for long-term FAA priorities as shown in Figure E.6. It remains to be seen if the FAA budget -- including funding for controllers, NextGen, and airport development -- will be paid by taxpayers, aided by new industry revenues (e.g., taxes on baggage and other ancillary fees), or cut back.

**Figure E.6. Aviation Funding: Demands Exceed Resources**



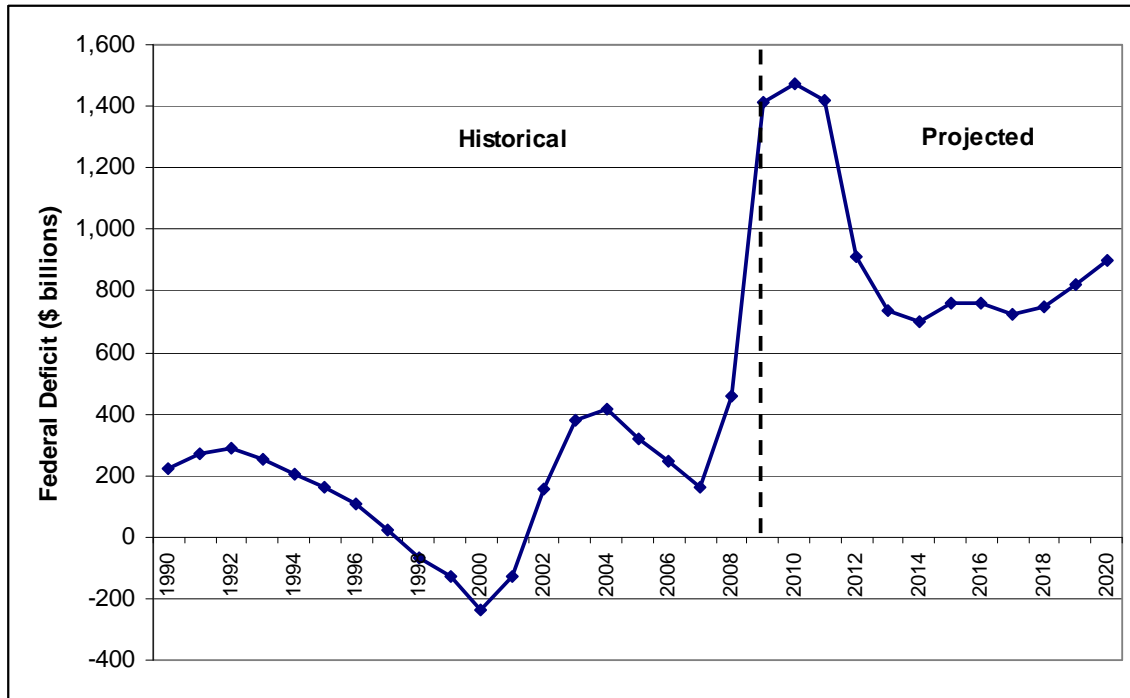
Source: Federal Aviation Administration.

However, given the fact that the U.S. federal deficit has ballooned as tax receipts have stalled and

<sup>19</sup> Congressional Research Service, *Budgetary Enforcement Procedures: Senate Pay-As-You-Go Rule*, RL31943 (January 12, 2010).

government spending has increased significantly (see Figure E.7), eventually pressures to reduce the deficit will impact transportation spending and policy.

**Figure E.7. Historical and Projected U.S. Federal Deficit**



Sources: Historical - usgovernmentspending.com; projection - OMB Mid Session Review, FY 2011, July 23, 2010.

In sum, with current and future spending commitments outpacing revenue generated from the AATF, federal deficits expanding, and new infrastructure commitments, transportation programs are either going to receive additional taxpayer contributions in what is a very competitive environment or programs, such as AIP, are going to have to be reduced..

Airports also have access to aeronautical and non-aeronautical revenues, which even with a declining federal program, can provide support for an airport’s capital program and support the maintenance and operation of the airport. But with most air carriers experiencing financial stress over the last decade, few airlines are likely to support increases in airport rates and charges to backfill the gap left by a declining AIP program or the failure to increase the PFC ceiling. Therefore, for those airport owners who find that the current federal program and local resources are insufficient, or for those who have other motivations to participate in the APPP, the conditions for the APPP are important.

#### **E.4 APPP and Political Uncertainty**

With the over 20 extensions of FAA authority since the end of FY 2007, there have been several proposals to change the APPP, both to expand and to restrict airport participation. Passage of any reform to the APPP would change the value of the program for airports owners.

In early 2007, the Bush Administration offered its legislative proposal (H.R. 1356—Next Generation Air Transportation System Financing Reform Act of 2007) to reform and reauthorize FAA programs and the ways users would be charged for accessing FAA services. Included were

proposals that would have made it easier under the APPP to divert revenue and raise aeronautical charges as well as increase the number of slots (“FAA Reauthorization”) as follows:<sup>20</sup>

- The legislation increased the APPP slots available from the 5 under current law to 15.
- It reserved none of the 15 slots, meaning any airport whether large or small, or commercial service or general aviation, could apply for the program until all 15 slots were committed.
- It eliminated the requirement that 65% of air carriers serving the airport (and those representing 65% of the landed weight) had to agree to the amount of the non-airport use of revenue. Airports only had to show that they had consulted with the air carriers prior to taking the action.
- The legislative proposal struck an additional APPP requirement that 65% of air carriers had to consent to any airport fee increase above the rate of inflation.
- It eliminated the restriction that percentage fee increases assessed on general aviation aircraft could not exceed the fee increases assessed on air carriers.

While making the APPP more attractive to airport owners as noted above, H.R. 1356 also proposed to make AIP less attractive.

- It proposed reducing federal support for AIP and shifting some the burden to airport users.
- It proposed a significant reduction in AIP, recommending \$2.750 billion for FY2008, \$2.900 billion for FY2009, and \$3.000 billion for FY2010.
- At the same time, it would have authorized airports to collect a \$6.00 PFC, requiring airports that raised it above \$4.50 to turnback 100% of their entitlements.
- Airports that participated in a new pilot program to take control of air traffic control navigational equipment could increase their PFC to \$7.00.

While certainly not defederalizing the FAA airport program, H.R. 1356 took a significant step in attempting to shift more responsibility to airports and or the private sector to fund future development.

It was in this context then that House Democrats, led by Transportation and Infrastructure Committee (T&I) Chairman James Oberstar (D-Minn.) offered H.R. 2881, the committee’s version of FAA reauthorization. In a rejection of the Bush Administration approach, their bill did not expand the number of slots available for the APPP. Instead, it took two measures to reduce the potential attractiveness of the APPP.

- It raised from 65% to 75% the threshold of approval for air carriers serving the airport (and air carriers representing that portion of the airport’s landed weight).

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<sup>20</sup> Congressional Research Service, *Federal Aviation Administration Reauthorization: An Overview of Selected Provisions in Proposed Legislation*, RL33920 (May 9, 2008).

- It eliminated all AIP eligibility for airports participating in the APPP.

Due in part to the wide ranging differences between the Bush Administration proposal and the congressional approaches, policymakers failed to reauthorize the FAA and its programs.

- In 2011, a new Republican controlled chairman of the House Transportation and Infrastructure Committee, Representative John Mica (R-Florida), steered through the House of Representatives H.R. 658, the FAA Reauthorization and Reform Act of 2011. The House-passed bill proposed several changes to the APPP, which if they became law, would increase the opportunities and improve the incentives for airports to participate in the APPP: The legislation increased the available slots from five to 10 and did not specify set-asides in the additional five slots.
- It eliminated the requirement that 65% threshold for air carriers to approve the diverting of airport revenue and replaced it with a requirement that the airport consult with each air carrier serving the airport.
- It included a new provision that stated that any fee assessed by an airport on an air carrier may not include “any portion for a return on investment or recovery of principal with respect to consideration paid to a public agency for a lease or sale of that airport unless that portion of the fee is approved by that carrier or foreign air carrier.”<sup>21</sup>

In combination, the latter two provisions mean that airports would not have to obtain air carrier approval provided that their taking revenue off the airport did not affect the fees paid by air carriers. Given most airports’ financial systems, this would not be very challenging as they could use non-aeronautical charges to recover their profit.

Public policy is an important variable that will continue to inform the choices of airport owners and communities. For existing airports, the choices with the APPP at present are constrained by the lack of available slots -- none for large hub airports and just one for all others. But, as a review of the last 15 years makes clear, the calculus for these choices may change, as federal policy potentially changes for airport policy generally and for the APPP specifically. Current budget realities may encourage policymakers to once again seek new ways of doing business. If so, airport owners and communities will have new choices to make.

## **E.5 Volatility in Municipal Bonds and Market Acceptance**

As noted earlier, most airport debt is in the form of tax-exempt municipal bonds. Since the fall of 2010, there has been significant volatility and stress in the U.S. municipal bond market due to unease about the need for a number of state and local governments to close the gap between spending and revenue collection. In an uncertain and skittish market environment, concerns about a municipal bond “bubble” triggered a sell-off in municipal bonds beginning in November 2010. Reasons cited for the sell-off included:<sup>22</sup>

- Weakening state and city finances and associated concerns about some issuers’ ability to

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<sup>21</sup> See 112<sup>th</sup> Cong., 1<sup>st</sup> sess., H.R. 658, Section 158 (<http://www.gpo.gov/fdsys/pkg/BILLS-112hr658rds/pdf/BILLS-112hr658rds.pdf>).

<sup>22</sup> Michael Corkery, *In Muni-Bond Ills, Danger and Hope*, Wall Street Journal, February 9, 2011.

repay their debts

- Media attention to the long-ignored underfunding of public pensions
- A sharp decline in the number of municipal bonds being insured (from 57% in 2005 to 6.2% in 2010 according to Bank of America Merrill Lynch)
- The Federal Reserve's program of buying bonds to encourage economic growth, which channeled some investors into a rallying stock market instead of bonds
- Congress' extension of the federal income-tax cuts in December 2010, which made it less urgent for some individuals to seek tax-exempt investments such as muni-bonds
- An extraordinary supply of new bonds in the fall of 2010 due to the December 31 expiration of the federally subsidized Build America Bonds program, which put downward pressure on prices.

The sell-off was exacerbated after a nationally televised prediction by a Wall Street analyst Meredith Whitney in December 2010 that there will be widespread bankruptcies and “billions of dollars in defaults” by 50 to 100 municipalities in 2011. While analysts say it is possible that the historically low rate of defaults could rise somewhat, many analysts and investors doubt the scenario outlined by Whitney.

As a result, tax-exempt/taxable ratios were near historic highs in mid-January 2011. For example, in 2011 the 30-year ratio reached a high of 112.1% -- the 10-year average was 98.3%. Also, municipal issuance volume in the first five months of 2011 was the slowest first five months in the past ten years and was 51% lower than the first 5 months of 2010.<sup>23</sup>

Going into 2011, media reports continued to focus on predictions of a broad wave of municipal defaults with Wisconsin lawmakers targeting civil servant pension benefits, concerns about Atlanta suburb DeKalb County's “unwillingness” to balance its budget, and California and New Jersey politicians clashing over budget deficits. Nevertheless, these dire predictions did not come to fruition. Muni prices rose from the lows they touched at the end of 2010 and staged a staggering rally in mid 2011 and bond purchases stabilized as illustrated in Figure E.8.

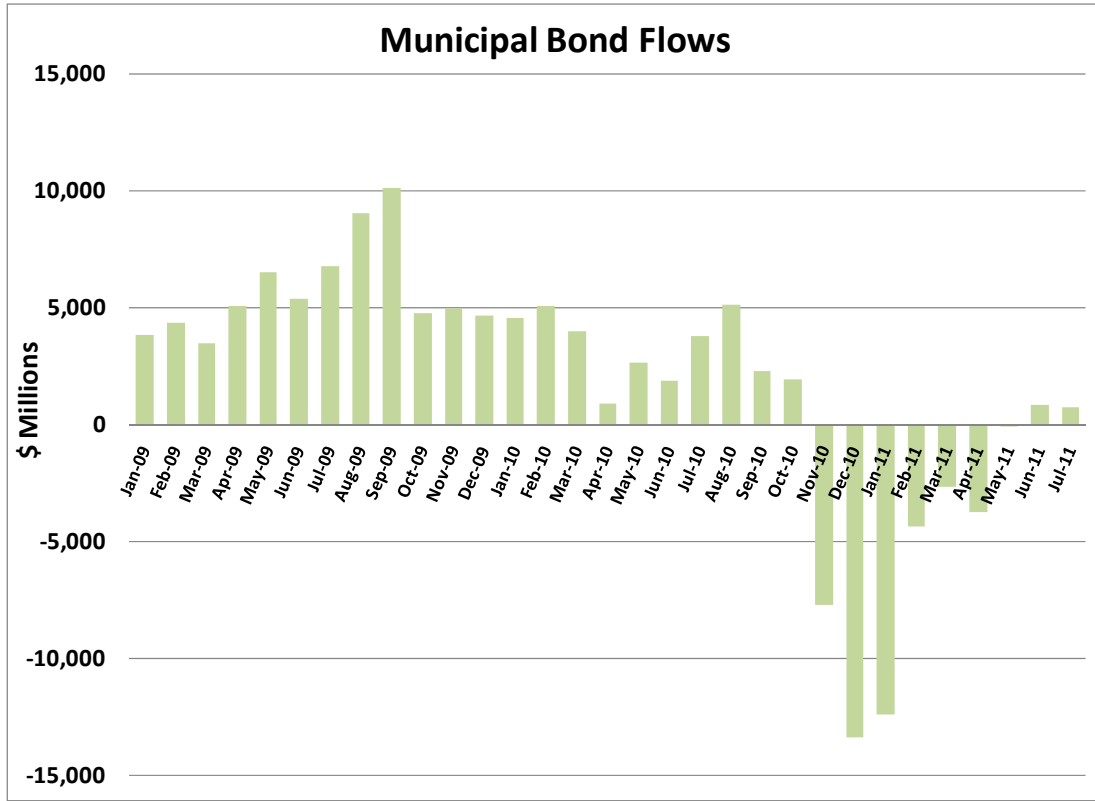
Then on August 5, 2011, Standard & Poor's downgraded the U.S. sovereign credit rating from AAA to AA+ with a negative outlook that triggered a worldwide sell-off of stocks, a ‘flight to quality’ (including most munis), and extreme volatility in the US Treasury market. Muni bond indices returned to their pre-November 2010 levels and investors returned to the muni market.

In sum, there has been considerable volatility in the muni market since the financial crisis of 2008. The market has not been the same since the collapse of the monoline insurers in 2008. Although credit spreads appear to have peaked in early 2009, they remain volatile as illustrated on Figure E.9.

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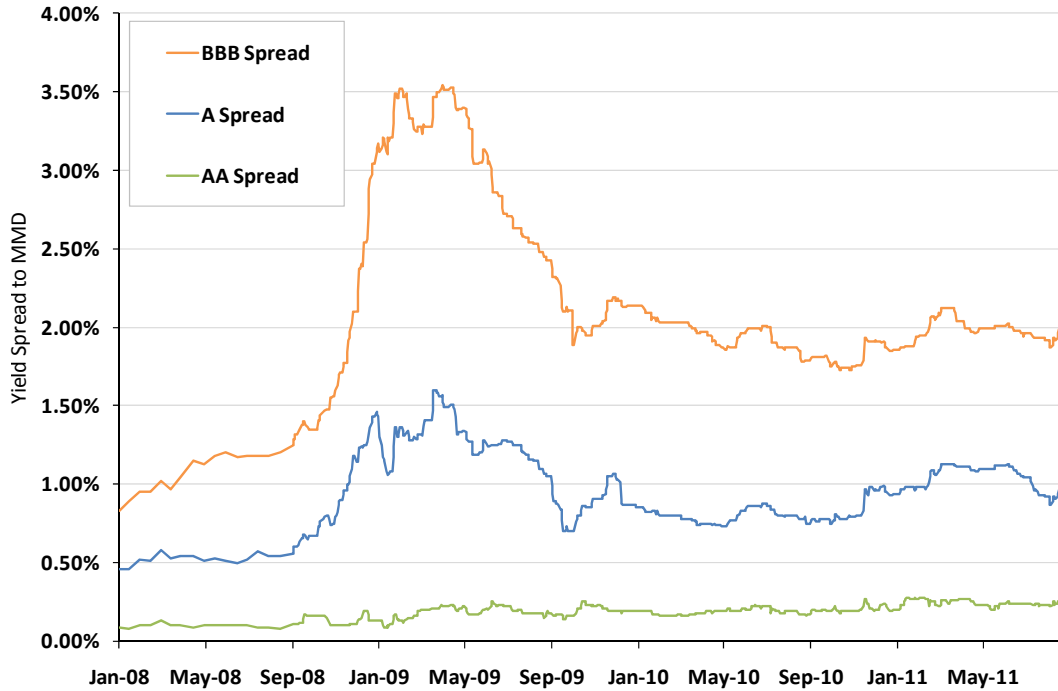
<sup>23</sup> Securities Data Corporation, June 3, 2011.

Figure E.8. Municipal Bond Flows



Sources: Investment Company Institute, *Long-term Mutual Fund Flows Historical Data*, as compiled by Morgan Keegan.

Figure E.9. 10-Year Maturity Spreads to AAA Municipal Market Data Bonds



Sources: Thomson Reuters as compiled by Morgan Keegan.

Note: Municipal Market Data is owned by Thomson Reuters. MMD municipal bonds are mostly investment grade or

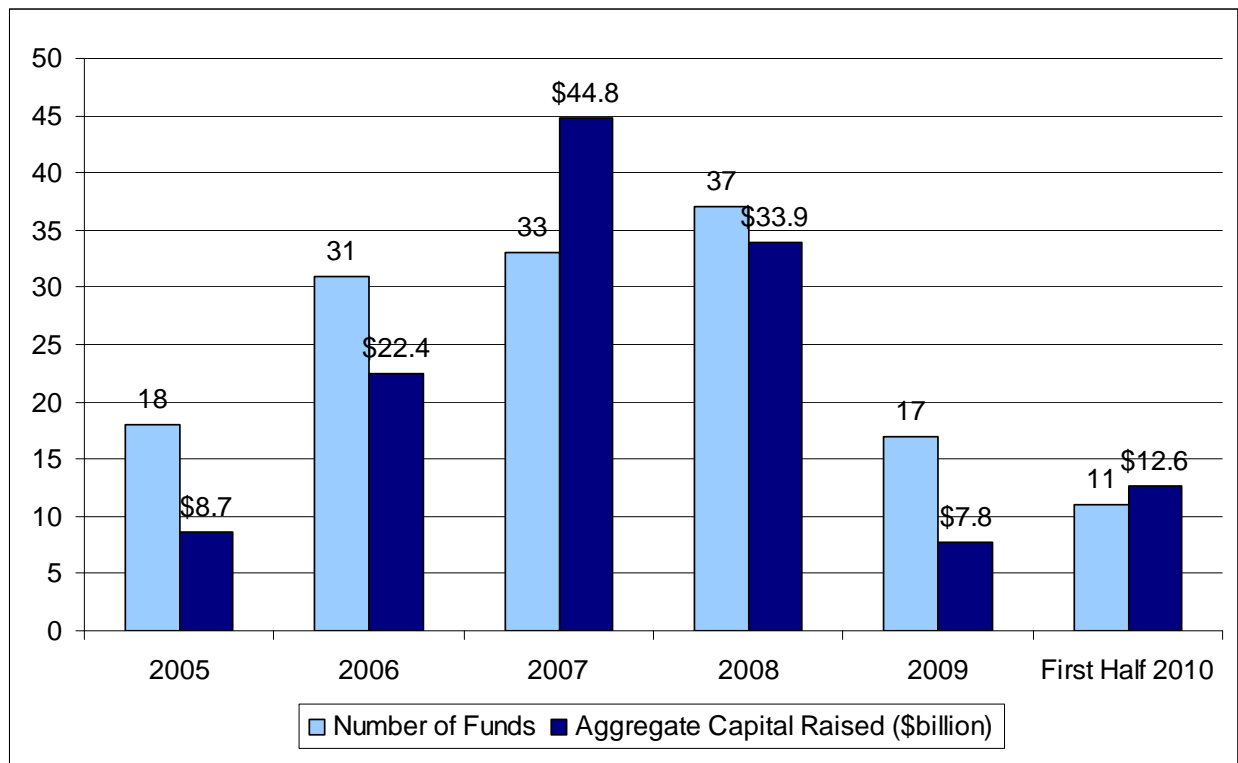
higher.

## E.6 Growth in Infrastructure Funds in the Private Equity Market

The preceding discussion addressed the demand side driving an interest in airport privatization in the U.S. There is also a very important dynamic fueling the supply side of this interest – significant growth in the amount of capital flowing into private equity infrastructure funds.

The infrastructure fund industry experienced significant growth in the first decade of this century as it evolved from a niche sector to a distinct asset class. According to Preqin, a British information provider for alternative assets, annual capital raised by non-listed (vs. publicly-traded) infrastructure funds increased from \$8.7 billion in 2005 to \$44.8 billion in 2007 before retreating to \$7.8 billion in 2009 due to the global financial crisis and economic downturn (please see Figure E.9). Fundraising has since recovered to \$12.6 billion for the first half of 2010.<sup>24</sup>

**Figure E.9. Unlisted Infrastructure Fundraising**



Source: Preqin Ltd., *The 2010 Preqin Infrastructure Review*, August 2010.

The growth in the infrastructure investment can generally be attributed to several factors.

- The increasing awareness of diversification has encouraged investors to seek non-traditional investment vehicles other than bonds or stocks. The infrastructure investment is typically viewed to have low correlation with other asset classes and low overall risks.

<sup>24</sup> Preqin Ltd., *The 2010 Preqin Infrastructure Review*, August 2010.



- Historical investments in infrastructure have provided satisfactory results. Although the targeted return ratios of infrastructure funds are typically lower than those of private equity funds, most infrastructure funds target 10% to 20% internal rate of return, according to Preqin.
- Pension funds are attracted by the relative long investment cycle provided by the infrastructure funds, which is a good match to the long horizon of pension fund obligations.

However, the global financial and economic crisis in late 2008 significantly impacted the infrastructure fund industry. Tight liquidity dried up funding sources for infrastructure investment. Investors became aware that performance of certain infrastructure investments, especially transportation-related ones, could be highly correlated to general economic conditions. Performance of any infrastructure fund is also affected by the fund management decision, availability of privatization opportunities, and deals reached, among other factors. Those concerns reduced the attractiveness of infrastructure funds as an alternative asset class.

Moreover, raising equity is just part of the equation because large private equity transactions (such as airport privatizations) are usually financed using material amounts of debt as well, which is typically underwritten by banks. A speech by Sally Dewar, Director of Markets Division for BBA Private Equity Briefing, on private equity risk and regulation received a great deal of attention when it came out in January 2007. Ms. Dewar pointed out the risks posed by the private equity market, including excessive leverage, unclear ownership of economic risk, market abuse, conflicts of interest, market access constraints, lack of transparency, and opaque valuation methodologies.<sup>25</sup>

Nevertheless, with the U.S. market becoming more receptive to the idea of privatization to meet its infrastructure capital needs and with the gap between what the federal government is expected to have available for airport infrastructure (as described above) and what airports will need to spend in the next five years, it is conceivable that these trends will drive significant demand for private capital in infrastructure and could stimulate another round of growth in infrastructure fund investment.

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<sup>25</sup> Sally Dewar, *Private Equity: a Discussion of Risk and Regulatory Engagement*, January 25, 2007.

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## Appendix E.1

### Acronyms

<b>AAAE</b>	American Association of Airport Executives (AAAE)
<b>AATF</b>	Airport and Airway Trust Fund
<b>ACI-NA</b>	Airports Council International – North America
<b>AIP</b>	Airport Improvement Program
<b>AIR 21</b>	Wendell H. Ford Aviation Investment and Reform Act for the 21 <sup>st</sup> Century also known as Public Law 106-181, enacted on April 5, 2000
<b>AMT</b>	Alternative Minimum Tax
<b>APPP</b>	Airport Privatization Pilot Program
<b>ARRA</b>	American Recovery and Reinvestment Act
<b>BABs</b>	Build America Bonds
<b>CCI</b>	Means Construction Cost Index
<b>CUTGO</b>	Cut-as-you-go
<b>FAA</b>	Federal Aviation Administration
<b>F&amp;E</b>	FAA Facilities & Equipment
<b>FY</b>	U.S. Federal Fiscal Year (ending September 30)
<b>HTF</b>	Highway Trust Fund
<b>PFCs</b>	Passenger Facility Charges
<b>NextGen</b>	Next Generation Air Transportation System Financing Reform Act of 2007
<b>PAYGO</b>	Pay-as-you-go
<b>TIGER</b>	Transportation Investment Generating Economic Recovery
<b>Vision 100</b>	Vision 100—Century of Aviation Reauthorization Act also known as Public Law 108–176, enacted on December 12, 2003

## **Appendix F**

### **U.S. Regulatory and Policy Framework**

#### **F.1 Objective of Appendix**

The purpose of this appendix is to describe the legal structure of U.S. airports and the effects of this structure on airport privatization, to describe the legal standards and procedures for privatizing an airport under the Airport Privatization Pilot Program, 49 U.S.C. § 47134 (“APPP”) and the standards and procedures for other forms of full and partial privatization, and to identify the lessons learned from prior and current efforts to privatize airports within the U.S. legal structure.

Appendix F.1 provides a list of acronyms for this chapter.

#### **F.2 Introduction**

The legal framework for operating public-use airports in the United States is unique and has significantly influenced the experience and evolution of airport privatization in this country. The U.S. legal structure provides abundant opportunities for airport owners and operators to enlist private participation in certain airport functions and facilities while retaining primary responsibility and control over the airport, referred to herein as “partial privatization”. At the same time, this legal structure significantly circumscribes opportunities to transfer the ownership and/or primary control of public-use airports to a private operator, referred to herein as “full privatization.”

In particular, airport operators agree to abide by extensive conditions in consideration for the receipt of federal grants under the Airport Improvement Program (AIP). This financing structure historically dis-incentivized full privatization as a result of (1) the availability of federal funding for public entities to build and develop airports; (2) the constraints imposed by the grant conditions, known as “sponsor assurances” or “grant assurances,” and (3) the prospect that public entities would be required to repay prior grants upon the sale or lease of an airport to a private operator. While Congress lowered certain barriers to full privatization through the APPP, it erected new conditions on privatization and left other limits in place.

#### **F.3 Legal Constraints on Airport Privatization**

Privatization implicates a wide range of legal principles affecting airport operations. The following subsections describe the primary features of the legal structure and those features that have directly influenced airport privatization.

##### **F.3.1 Basic Legal Structure of Airports**

Although private enterprise initially played a role in building and operating commercial service airports, today virtually all commercial service airports, and most public-use general aviation airports, are owned and controlled by a state, regional, or municipal entity. These state and local governments are imbued with powers under state law necessary to operate, maintain and develop airports, such as the power to acquire and lease property, issue debt, enter into contracts, sue and be sued, etc.

Beginning with the Civil Aeronautics Act of 1938 and the Federal Airport Act of 1946, the federal government imposed a series of overlapping controls and requirements on public-use airports. The most extensive and demanding requirements are the grant assurances. There are 39 grant assurances, controlling *both* the manner in which the airport owner must carry out grant-funded projects and the manner in which the airport owner must operate the airport. The grant assurances control such diverse topics as the treatment of aeronautical users, rate-setting, reporting, planning, encroachment, civil rights, and land acquisition.

Several grant assurances are particularly relevant here, including the following:

1. *Assurance 5* prohibits the airport owner from taking action that would deprive it of the rights and powers necessary to comply with the other grant assurances, and prohibits the transfer of airport property without FAA approval.
2. *Assurance 20* requires the airport owner to take appropriate action to mitigate airport hazards and prevent future hazards.
3. *Assurance 21* requires the airport owner to take appropriate action to promote compatible land uses around the airport.
4. *Assurance 22* requires the airport owner to make the airport available for public use on reasonable terms and without unjust discrimination.
5. *Assurance 23* prohibits an airport owner from granting an exclusive right to conduct an aeronautical activity at the airport.
6. *Assurance 24* requires the airport owner to impose rates and charges in such a manner and at such levels as to make the airport as self-sustaining as possible under the circumstances.
7. *Assurance 25* requires the airport owner to use airport revenue only for the capital and operating costs of the airport, the local airport system, or other local facilities owned or operated by the airport owner and which are directly and substantially related to the air transportation of passengers or property.

Beyond the grant assurances, there are several additional direct and indirect federal controls on airports that are relevant to the discussion of privatization, particularly including the following:

- *Airport Operating Certificates* – Unlike pilots, air carriers and aircraft, each of which is required to be licensed or certificated, only airports that accommodate certain types of aeronautical activities are required to be certified by the FAA. Specifically, federal law requires that airports with scheduled air carrier operations in aircraft with more than 9 seats and/or unscheduled air carrier operations in aircraft with more than 30 seats must obtain and comply with an Airport Operating Certificate.<sup>1</sup> Airports without the triggering level of commercial passenger service, and General Aviation airports with no commercial passenger service, are not required to maintain an Airport Operating Certificate, but are subject to the grant assurances. The statute's implementing regulations, found at 14 C.F.R. Part 139, require each certificate holder to take certain actions and satisfy certain standards concerning, for example, runway safety areas, airfield marking and lighting, wildlife hazards,

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<sup>1</sup> 49 U.S.C. § 44706.

and aircraft rescue and firefighting. The requirement to obtain and abide by the conditions of an Airport Operating Certificate applies equally to public and private operators.

- *Surplus Property Act Deed Restrictions* – The Surplus Property Act of 1944 and subsequent statutes authorized the federal government to convey airports that it owned and operated to public entities for civil use at no cost.<sup>2</sup> The transfer was conditioned on, among other things, the public entity making the airport available for public use on reasonable conditions and without unjust discrimination and without granting exclusive rights to conduct aeronautical activities. The federal government can retake title to the property in the event of default.
- *Prohibition on Revenue Diversion* – Federal law, in addition to the grant assurances, prohibits the use of airport revenue for purposes other than airport capital and operating costs.<sup>3</sup> This rule was designed to ensure that the federal investment in airports would not be undermined by redirecting revenue derived from airports to other government functions. As described throughout and in the referenced source material, this prohibition on “revenue diversion” historically was the principal constraint on full privatization because it meant, among other things, that the public entity that owned the airport could not use the proceeds from the sale or lease for non-airport purposes.
- *Prohibition on Granting Exclusive Rights* – Federal law, in addition to the grant assurances, prohibits the grant of an exclusive right to conduct aeronautical activities at airports that have ever received federal financial assistance.<sup>4</sup> Unlike the grant assurances, which may have a limited duration, this proscription lasts in perpetuity. This prohibition applies only to aeronautical activities. It does not prohibit monopolies in, for example, car rentals, parking, and concessions. Moreover, airport management itself is not an aeronautical activity.
- *Controls on Rate-setting* – The Anti-Head Tax Act (“AHTA”) imposes a requirement, independent of the grant assurances, that public entities operating airports must impose only “reasonable” charges for aeronautical use of the airport.<sup>5</sup> Congress later required the U.S. Department of Transportation (USDOT) to issue guidance on how it would evaluate fee disputes.<sup>6</sup> USDOT issued its policy on rates and charges in 1996, and amended the policy in 2008.<sup>7</sup> Like the statutory prohibition on exclusive rights, the AHTA applies only to

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<sup>2</sup> Current authority is found at 49 U.S.C. § 47151.

<sup>3</sup> 49 U.S.C. § 47133(a) (“Local taxes on aviation fuel (except taxes in effect on December 30, 1987) or the revenues generated by an airport that is the subject of Federal assistance may not be expended for any purpose other than the capital or operating costs of – (1) the airport; (2) the local airport system; or (3) any other local facility that is owned or operated by the person or entity that owns or operates the airport that is directly and substantially related to the air transportation of passengers or property.”).

<sup>4</sup> 49 U.S.C. § 40103(e) (“A person does not have an exclusive right to use an air navigation facility on which Government money has been expended.”)

<sup>5</sup> 49 U.S.C. § 40116(e) (“Except as provided in subsection (d) of this section, a State or political subdivision of a State may levy or collect - . . . (2) reasonable rental charges, landing fees, and other service charges from aircraft operators for using airport facilities of an airport owned or operated by that State or subdivision.”).

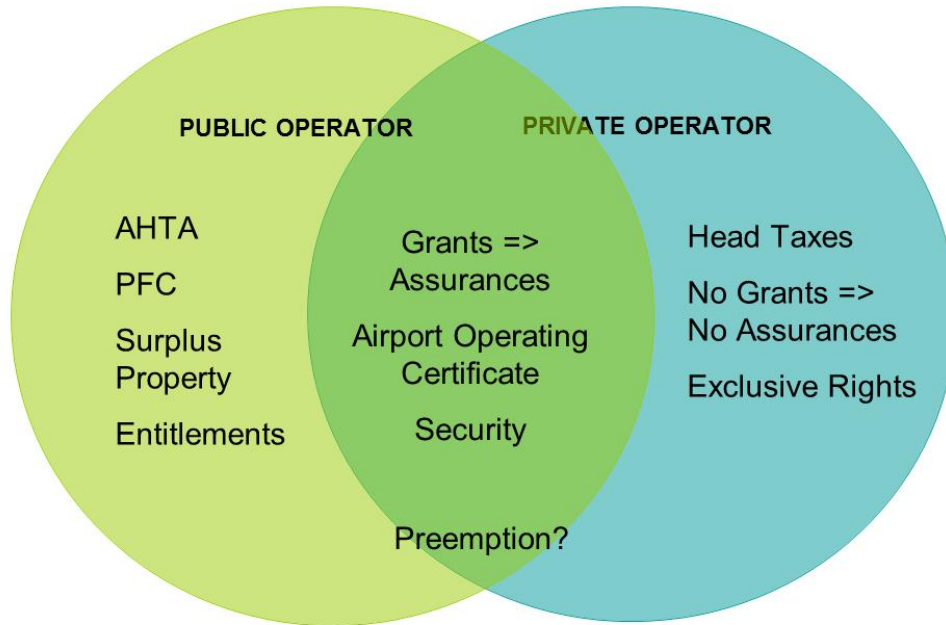
<sup>6</sup> 49 U.S.C. § 47129.

<sup>7</sup> Under the policy, airports may recover only “historic” costs for airfield assets and public use roadways, but for non-airfield facilities, the policy permitted fees to be set by any “reasonable” method. The U.S. Court of Appeals vacated provisions of policy regarding the rules distinguishing between airfield and non-airfield fees and remanded the matter to USDOT. *Air Transport Ass’n of America v. DOT*, 119 F.3d 38 (D.C. Cir. 1997) amended by 129 F.3d 625 (D.C. Cir.). USDOT has not amended the policy to address this issue and instead has adjudicated disputes over non-airfield rates

aeronautical users of an airport. The rates imposed upon non-aeronautical users are subject to less demanding standards under the U.S. Constitution.

Figure F.1 is a summary of the legal constraints applying to public and private operators and shows the overlap between the two business models.

**Figure F.1. Legal Constraints on Public and Private Operators**



### F.3.2 Effects of Legal Structure on Privatization

These direct and indirect federal controls dramatically affect the incentives and opportunities for privatizing public-use airports. The following requirements have influenced whether public airport operators have pursued partial or full privatization, and more specifically, have created opportunities for an airport owner to enlist private participation while remaining the airport sponsor (partial privatization) and simultaneously erected barriers to transferring sponsorship to a private operator (full privatization):

- *FAA approval authority* – Assurance 5 requires FAA approval before the airport owner can “sell, lease, encumber or otherwise transfer or dispose of any part of its title or other interests” in the airport. The Surplus Property Act and subsequent statutes authorizing transfer of federal property for public airports contain similar requirements. In practice, FAA approval is required only for a sale or long-term lease of airport property to a public or

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and charges on a case-by-case basis. In 1999, the U.S. Court of Appeals confirmed USDOT’s determination that historic cost, and not “opportunity cost”, is the appropriate method of setting rates for airfield assets, in the context of a dispute over rates and charges at Los Angeles International Airport. *City of Los Angeles v. DOT*, 165 F.3d 972 (D.C. Cir. 1999). In 2009, the U.S. Court of Appeals remanded a subsequent dispute over rates and charges at LAX to USDOT to justify its disparate treatment of airfield and non-airfield assets. *Alaska Airlines v. DOT*, 575 F.3d 750 (D.C. Cir. 2009).

private entity. Public airport owners can enter into management contracts, concession agreements, leases of airport facilities and a host of other agreements with private entities without FAA approval. USDOT and FAA thus act as the gate-keeper to full privatization. Historically, full privatization efforts effectively were halted when FAA interjected itself into the process to explain the applicable federal conditions and requirements.

- *Revenue use* – Both federal law and the grant assurances strictly limit the use of airport revenue for non-airport purposes. “Airport revenue” is defined broadly to include the proceeds from the sale or lease of airport property. There are some narrow exceptions, such as for so-called “grandfathered” airports and for repayment of loans issued by sponsoring governments. However, Congress has expressed serious concern with revenue diversion and has prescribed onerous penalties for violations. The prohibition on revenue diversion applies only to the airport owner, not the air carriers, fixed base operators (FBOs), concessions, private airport managers, or any other private entities that conduct business on an airport. This has incentivized private ventures on airports but dis-incentivized full privatization. It presents a particularly high barrier to full privatization because the public airport owner is required to use the sale proceeds for airport purposes, and because the private operator, upon assuming responsibility for the grant assurances, must use revenue that it generates in connection with the airport for airport purposes.
- *Grant eligibility* – Under the Airport Improvement Program, public entities are eligible to receive an apportionment from the Entitlement Fund and to receive grants from the Discretionary Fund. In contrast, private entities are not eligible to receive an apportionment, and only private operators of certain types of airports are eligible for certain types of discretionary grants. Specifically, public-use airports operated by a private entity that are designated as relievers or that have at least 2,500 annual passenger boardings are eligible for funding for airport development projects, airport master planning, noise compatibility planning and noise program implementation projects. As explained more fully in Task 6, this financing structure historically dis-incentivized full privatization because it encouraged public entities to retain the role of sponsor, and thus eligibility for funding under the AIP.
- *Grant repayment* – As described in greater detail below, another historical barrier to full privatization was the uncertainty as to whether a public airport owner would be required to repay the federal government upon sale or long-term lease to a private operator, for the value of land acquired from the federal government under the Surplus Property Act, for the value of land acquired with federal financial assistance, or for the value of grant-funded capital improvements. The relevant statutes clearly require reinvestment or repayment in the event the property is sold for a non-airport use; however, the statutes are ambiguous as to whether the reinvestment or repayment obligation is triggered by transfer of the airport to a private operator for continued use as a public airport. This uncertainty historically dis-incentivized full privatization because of the potential financial liability associated with privatization. However, Congress and the FAA effectively resolved this uncertainty by declaring that repayment typically would not be required to fully privatize an airport.
- *Control over non-aeronautical activities* – Based on the legal authorities noted above, airport owners have considerably greater control over non-aeronautical activities than aeronautical activities. For example, airport owners must charge a minimum of fair market value for non-aeronautical use, but have considerable flexibility, subject to Constitutional standards, to



charge higher amounts for rent and other fees. Similarly, airport owners are not subject to the prohibition on granting exclusive rights with respect to non-aeronautical users of an airport. While public airport operators theoretically are subject to suit under the anti-trust statutes, many courts have found that public entities are immune from liability for certain anti-competitive behavior. Private entities would not enjoy similar immunity. Overall, this legal structure supports *both* full and partial privatization. As to full privatization, the greater control and flexibility over non-aeronautical activities presents the opportunity for a private operator to generate a return on its investment by maximizing non-aeronautical revenues to the greatest extent permitted by the market. As to partial privatization, airport operators can enlist private participation in non-aeronautical activities through, for example, master concession agreements and similar vehicles, to give private enterprise a significant role in non-aeronautical activities.

- *Constitutional Rights and Protections* – State and local governments acting as airport operators must not deprive airport tenants and users of the rights and protections afforded by the U.S. Constitution. These rights and protections include, for example, freedom of speech and the press under the First and Fourteenth Amendments, and equal protection and due process rights under the Fifth and Fourteenth Amendments. While private parties typically are *not* responsible for guaranteeing Constitutional rights and protections, courts have applied the Constitution to private actors providing a “public function”<sup>8</sup> or where the private action is “entwined” or “entangled”<sup>9</sup> with state action. One court has held that a private entity operating an airport pursuant to a lease with the public airport owner is subject to the Constitution.<sup>10</sup> However, the extent to which private airport operators engaged in the range of activities described herein as full and partial privatization would be deemed state actors responsible for guaranteeing Constitutional rights and protections is uncertain.
- *Property Taxes* – Public airport operators enjoy exemptions from property taxation pursuant to the constitution and/or laws of most states. This exemption typically is limited to a public entity operating an airport and therefore would not apply to a private operator of a public-use airport. This tax structure dis-incentivizes full privatization, at least any transfer that would jeopardize the airport’s eligibility for an exemption.

#### **F.4 Events Leading to the Airport Privatization Pilot Program**

When the APPP became law as part of the 1996 FAA Reauthorization Act, it was the result of a decade-long effort by the FAA and the U.S. Department of Transportation (USDOT) to resolve

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<sup>8</sup> *Lebron v. Nat’l R.R. Passenger Corp.*, 513 U.S. 374, 115 S.Ct. 961, 130 L.Ed.2d 902 (1995); *West v. Atkins*, 487 U.S. 42 (1988) (private physician employed part-time by a state prison hospital); *Lugar v. Edmondson Oil Co.*, 457 U.S. 922 (1982) (private seizure of property executed under a state garnishment statute); *Terry v. Adams*, 345 U.S. 461 (1953) (privately-run public elections); *Marsh v. Alabama*, 326 U.S. 501 (1946) (conduct on public streets in a company town); *but see Blum v. Yaretsky*, 457 U.S. 991 (1982) (private nursing home receiving government funds), *Rendell-Baker v. Kohn*, 457 U.S. 830 (1982) (private, remedial high school receiving government funds); *Moose Lodge No. 107 v. Irvis*, 407 U.S. 163 (1972) (private club with a state-issued liquor license).

<sup>9</sup> *Brentwood Acad. v. Tenn. Secondary Schools Athletic Ass’n*, 531 U.S. 288 (2001) (private athletic association 84% of whose members are public schools); *Evans v. Newton*, 382 U.S. 296 (1966) (public park created by private will, but maintained and supervised by a municipality); *Pennsylvania v. Bd. of Dir. of City Trusts of Philadelphia*, 353 U.S. 230 (1957) (private school operated by a state agency); *but see Nat’l Collegiate Athletic Ass’n v. Tarkanian*, 488 U.S. 179 (1988) (national athletic association with members from many states not a “state actor” with respect to Nevada law).

<sup>10</sup> *Niswonger v. Am. Aviation, Inc.*, 424 F. Supp 1080 (D. Tenn. 1976).

several outstanding issues with leasing or selling publicly funded and regulated U.S. airports. The APPP was a compromise between privatization advocates and those skeptical about, or downright hostile, to it. The new pilot program, by resolving several legal uncertainties, created the conditions for a limited version of airport privatization.

#### **F.4.1 Early Efforts at Privatization**

While the requirement that airport owners agree to abide by certain conditions in exchange for federal assistance has been in place since the Federal Airport Aid Act of 1946, the current policy regime was established by the Airport and Airway Improvement Act of 1982 (AAIA).<sup>11</sup> Beginning with the AAIA and through subsequent amendments, Congress set forth the principle captured in Assurance 25 that *any* airport revenue, including revenue received through commercial activities of the airport unrelated to air transportation, be used for the capital and operating costs of the airport, the local airport system, or other facilities owned or operated by the airport owner. The logic was clear: Congress was only going to provide airports with grant money if they were assured that airport monies that otherwise could be available for capital development, were not transferred to an illegitimate use, such as balancing local or state budgets. Forbidding “revenue diversion” was viewed as protecting taxpayers, aviation passengers and airlines and, in fact, the integrity of AIP itself. The prohibition on revenue diversion was then--and is today-- supported by the airport community as the principal protection against local politicians using aviation money, much of it collected from those outside their jurisdictions, to subsidize other services.

Because any proceeds from a lease or sale are deemed to be airport revenue, however, this prohibits an airport owner from taking the sale or lease proceeds and using it for a non-airport purpose. Indeed, cashing out the value of an airport by sale or lease to use the revenue for a non-airport purpose arguably is the most extreme form of the problem that Congress, USDOT and FAA set out to stop. As the proceeds are one of the most important benefits an owner would potentially receive from privatizing an airport, its unconditional application would strongly discourage privatizations.

Occurring just after the AAIA was passed and when FAA was just beginning to put in rules to implement the statute, privatization posed some regulatory challenges. In 1986 (after the AAIA’s prohibition on revenue diversion but prior to the FAA’s issuance of a formal policy statement), the FAA approved the lease of the Atlantic City International Airport’s passenger terminal to Johnson Controls World Services, a private firm, for an annual minimum payment of \$400,000. The money was not reinvested in the airport, but was diverted to the city’s general fund for non-airport purposes. During this time, the FAA continued to provide grants to the airport. Six years later, the City sold the airport for \$11.5 million and annual payments of \$500,000, which were deposited in the City’s general fund.<sup>12</sup> The GAO notes that the 1992 deal was specifically sanctioned in a 1992 law passed by Congress.<sup>13</sup>

Following the Atlantic City lease, beginning in 1989, leaders of Albany County (New York) explored several options for leasing Albany County Airport.<sup>14</sup> They did so for three stated reasons. First, a

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<sup>11</sup> Public Law 97-248.

<sup>12</sup> U.S. Government Accounting Office, *Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports*, GAO/RCED 97-3 at 36 and 37 (November 1996)

<sup>13</sup> Public Law 102-143. § 335.

<sup>14</sup> For a good description see Kennedy School of Government Case Program, President and Fellows of Harvard College, *Privatizing the Albany County Airport: Abridged C16-91-1024.3* (1991).

desire to reduce the risk to local taxpayers, who had previously subsidized the airport out of the County's general fund, especially during the 1970s and 1980s. Second, leaders hoped to procure resources from one of the region's top assets, given that Albany County was then experiencing an economic downturn and its airport was by then running an operating surplus. And third, an effort to determine whether or not some of the proceeds from privatization could be used to upgrade the airport, widely perceived by the local community to be a substandard facility for New York's capital city.

The county assessed several options, including a sale and lease with a local public regional transportation authority and to private firms. After working with the FAA and legal counsel, the county presented an option to the FAA that, in turn, sought guidance from the U.S. Department of Justice (DOJ). FAA officials sought guidance, in part, because of the complexities of the matter and because they had given a variety of opinions on several iterations of Albany County's proposals over the 1989 to 1991 period. It took a legal opinion to clarify several outstanding legal matters.<sup>15</sup>

The county proposal was for a 40-year lease, with an option for an additional 40 years. The deal was to be between the county and a private, joint venture of British American Ltd. and Lockheed Air Terminal (BALLAT). BALLAT offered the county \$30 million as an initial payment for a 170-acre parcel adjacent to the airport, which it would then sell back to the county for \$1. The county would divert the \$30 million for general expenses to obligations unrelated to the airport. The county would also receive annual payments of \$500,000 for the first 20 years of the lease, and \$1 million for the next 20 years, depositing the lease payments in an interest-bearing fund dedicated to airport development. BALLAT would recoup its \$30 million from airport revenues, including landing fees.

Both the FAA and the county accepted that the \$30 million constituted airport revenue and both also agreed that the county could reasonably recoup some of the subsidies ("unreimbursed capital and operating expenses") from airport revenue, which the county had paid to the airport over the years. The county tallied these at \$26.3 million.<sup>16</sup> The FAA believed that the recovery should be proximate or spelled out at the time when the subsidies were provided; otherwise it was revenue diversion. DOJ, however, could find no statutory basis for a time limitation on recouping the subsidies and sided with the county's position that it did not constitute diversion. However, on one other critical matter, DOJ sided with FAA. The opinion found, consistent with today's grant assurance 22, that the "FAA may oversee the rates charged to airport users by BALLAT—including the extent to which they may permissibly reflect BALLAT's \$30 million payment to Albany County."<sup>17</sup> The themes of the Atlantic City and Albany cases – revenue diversion, recouping past investments, concern for users, and regulation of rate setting – would be critical elements that would have to be resolved in future privatizations of AIP-supported airports and would become cornerstones of the APPP.<sup>18</sup>

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<sup>15</sup> Office of Legal Counsel, U.S. Department of Justice Legal Opinion, *Re: Application of the Airport and Airway Improvement Act to the Proposed Lease of Albany County Airport* (Feb. 12, 1991). Included in U.S. Senate, Subcommittee on Aviation, Committee on Commerce, Science and Transportation, 104<sup>th</sup> Congress, 2<sup>nd</sup> session. *Hearing on Airport Revenue Diversion* (S. Hrg. 104-629) at 155-167 (May 1, 1996).

<sup>16</sup> *Id.* at 158.

<sup>17</sup> *Id.* at 167.

<sup>18</sup> The Federal Aviation Administration Reauthorization Act of 1996 addressed this issue by setting a six-year statute of limitations on unreimbursed expenses. *See* 49 U.S.C. § 47107(j)(5).

In the late 1980s and early 1990s, the issues of revenue diversion and rate-setting were growing concerns. Two different USDOT Inspector Generals alleged dozens of cases of airport owners illegally diverting airport revenue, including the over-estimation of unreimbursed capital and operating expenses.<sup>19</sup> At the same time, there were a growing number of disputes on the fees assessed by airports on the airlines and other users of their facilities. Ultimately this would lead to Congress in the FAA Reauthorization Act of 1994 requiring USDOT to issue “final regulations, policy statements, or guidelines” governing airport fees and the settling of airport-airline disputes.<sup>20</sup> While possible privatizations were not the primary focus of these disputes, a comprehensive approach to privatization demanded that USDOT and FAA *first* resolve what public airport owners could charge airlines and other users and *then* consider whether the same or different rules apply to private operators.

#### F.4.2 Federal Efforts at Privatizing Infrastructure

Even as the FAA and USDOT were attempting to resolve uncertainties for Albany County Airport and for airport regulation generally, both the Bush and Clinton administrations were asking their executive agencies to explore how they could encourage state and local governments to experiment with the concept of privatization and the greater use of private-sector financing.

- *Executive Order 12803* – On April 30, 1992, President George H.W. Bush signed Executive Order 12803, which was intended to reduce the barriers to privatization based on the principle that “State and local governments should have greater freedom to privatize infrastructure assets.”<sup>21</sup> The Order specifically required the heads of executive departments and agencies to “[r]eview those procedures affecting the management and disposition of federally financed infrastructure assets owned by State and local governments and modify those procedures to encourage appropriate privatization of such assets consistent with this order.”<sup>22</sup>
- *Executive Order 12893* – On January 26, 1994, President William J. Clinton signed Executive Order 12893 that, while not focused directly on the subject of privatization, stated, “Agencies shall seek private sector participation in infrastructure investment and management.”<sup>23</sup>

In 1995 as the 104<sup>th</sup> Congress convened, privatization would get a jump-start aided by sympathetic Republicans in the House of Representatives. Republicans had won control of the House for the first time in 40 years and many in the majority party believed in reducing the size and scope of the federal government, including its role supporting state and local infrastructure. For example, in June 1995, Representative McIntosh of Indiana sponsored H.R. 1907, the Federal-aid Facility Privatization Act of 1995. Like Executive Order 12803, the bill was intended to require executive departments and agencies to “[a]ssist State and local governments in their efforts to privatize their

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<sup>19</sup> See, for example, Airport Cooperative Research Program, *Legal Research Digest 2: Theory and Law on Revenue Diversion* at 26 and 27 (May, 2008).

<sup>20</sup> Public Law 103-305. In 1996, USDOT announced its Policy Regarding Airport Rates and Charges, 61 Fed. Reg. 31, 1994 (June 21, 1996). It remains a subject of airport-airline disputes today.

<sup>21</sup> Exec. Order 12803, § 2(a) (April 30, 1992).

<sup>22</sup> *Id.* § 3(a).

<sup>23</sup> Exec. Order 12893, § 2(c) (Jan. 26, 1994).

infrastructure assets.”<sup>24</sup> The bill specifically addressed the issues of grant repayment and revenue use.<sup>25</sup> The bill, and a companion bill in the U.S. Senate, did not reach the floor for a vote.

In contrast, in the early to mid-1990s, for the U.S. airport industry and the vast majority of airport owners and CEOs, selling or leasing an airport was something that was occurring in the rest of the world and did not have particular relevance to them. In the U.S., public airports had federal airport capital grants funds available (AIP), new authorization to collect passenger facility charges (PFCs) from passengers, and access to tax-exempt debt, which reduced the borrowing rates available to them in the capital markets by as much as 200 to 250 basis points (2.00% to 2.50%). In addition, many had long-term use and lease agreements with the airlines that would have to be renegotiated if they sought to change the rate-setting methodology.

PFCs, in particular, recently passed as part of the Aviation Safety and Capacity Act of 1990, provided airports with the ability to charge passengers up to \$3.00 per departure (with a maximum of two PFCs for a one-way passenger itinerary).<sup>26</sup> While PFCs required airport consultation with airlines and federal approval, they were exempted from the terms of airport-airline use and lease agreements and thus provided a new source of capital independent of the airlines. For the vast majority of airport operators, the new PFC was far more relevant than was privatizing their airports, and by providing public airport owners with a new source of available capital, actually became a reason for airports not to privatize.

U.S. airport CEOs also valued the fact that they were public. First, unlike some of their non-U.S. counterparts, they were not responsible to a larger corporation and shareholders and did not have to meet annual expectations of delivering profitable returns. Airports do have to be as “self-sustaining” as possible under grant assurance 24, but for many airports with use and lease agreements that allow them to recover their costs, this is not normally a high hurdle, and a requirement to be self-sustaining is certainly a lower expectation than those faced by a private airport. Second, because they do not have to make a profit, U.S. airports can think of providing service as their bottom-line—air service, providing access to their community, and service to the passengers and other users who pass through their facilities. Third, self-interested airport CEOs recognize that they are chosen according to public criteria by public boards. Fourth, the movement to privatize infrastructure in the U.S., while garnering more attention, was still in its infancy. Fifth and finally, to the extent that communities considered transferring primary responsibility for the airport to another entity, the first choice typically was another public entity, particularly airport authorities or intergovernmental authorities, which explicitly had been provided for in many state statutes. For many, therefore, privatization was simply not salient to their daily experience.

### **F.4.3 Congressional Debate Leading to Section 47134**

In February and March 1996, the House Subcommittee on Aviation held a series of hearings in preparation for FAA Reauthorization. On February 29, 1996, the Subcommittee held a hearing exclusively dedicated to the issue of airport privatization.

The introductory comments from members of the Subcommittee did not suggest strong support or enthusiasm for airport privatization. No statements were made on the record about the ideological

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<sup>24</sup> H.R. 1907, § 3(a).

<sup>25</sup> *Id.* §§ 5 and 6.

<sup>26</sup> Public Law 101-508. The PFC program today is contained in 49 U.S.C. § 40117.

benefits of smaller government and the need for greater participation by private enterprise. Rather, each member indicated that the primary benefit of privatization would be to provide an alternative funding source for airport development, made necessary by the inability of traditional sources to support needed capital development. (This hypothesis is examined more fully in Task 6.)

The Subcommittee heard testimony from the U.S. General Accounting Office; the Air Transport Association; the Airport Group International; BAA USA; Rothschild, Inc.; and the Port Authority of New York and New Jersey. The ATA representative stated the airlines opposition to airport privatization generally, and to Representative McIntosh's H.R. 1907 in particular. The remaining speakers described, in somewhat generalized terms, the benefits to be gained by airport privatization.

The U.S. General Accounting Office submitted testimony focusing particular attention on the prohibition on revenue diversion and the potential need to repay past grants as the principal legal barriers to airport privatization.<sup>27</sup> Referring to the Albany case and the DOJ opinion in particular, GAO also identified the lack of clear rules and guidelines from FAA as a further impediment to privatization.

In the subsequent months, the House of Representatives developed and adopted a pilot program as part of H.R. 3539, its version of FAA Reauthorization:

- *Participation:* USDOT could approve up to six airports in the program, at least one of which had to be a non-commercial service airport;
- *Revenue Diversion:* With the approval of 60% of the air carriers serving the airport and the approval of air carriers representing 60% of the total landed weight at the airport, the Secretary could exempt participating airports from the prohibition on using airport revenue for non airport purposes. Thus, the sponsoring authority could use the proceeds from the sale for any purpose. The exemption could be revoked if a privatized airport violated the terms of the program.
- *Repayment of Federal Grants and Donated Federal Land:* H.R. 3539 allowed the Secretary to waive the requirement that a privatized airport would have to repay federal grants or the value of federal land that had been made part of the airport.
- *Rate-Setting:* Two requirements circumscribed airport rate-setting. First, the same 60% of air carriers would have to approve any fee assessed on air carriers that was above the rate of inflation. Second, the airport had to be made available on "reasonable" terms, meaning the FAA and USDOT retained their regulation of the rates charged by privatized airports.
- *Access to Capital:* participating airports could continue to have access to AIP entitlements and could assess PFCs on air carriers.<sup>28</sup>

The House version met many of the goals of the various parties. For privatization advocates, the concept of privatization would get a trial, lasting as long as the period of the authorization. For the FAA, airports under the privatization pilot program would remain regulated and its interests in protecting access to the facilities on reasonable terms were retained. For air carriers, they could be assured that their approval would be required, giving them significant leverage over the terms of any

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<sup>27</sup> U.S. General Accounting Office, *Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports* (Statement of Gerald Dillingham), GAO/T-RCED-96-82 (Feb. 29, 1995).

<sup>28</sup> 104<sup>th</sup> Congress, H.R. 3539, FAA Authorization Act of 1996.

lease and, even once approved, their approval would be required for any fee increases above the rate of inflation and they would continue to have protection against any unreasonable fees assessed by the airport.

Representative Tom DeLay (R-Texas), the House Majority Whip, spoke favorably of the pilot program: “Cities and counties should have the discretion to consider airport privatization as a means to fund needed capital improvements and promote economic development. It is clear that federal airport development resources will be limited. And, many cities need to create new capacity at their existing airports to meet surging demand for air services, creating pressure on cities and counties to consider alternative sources of capital.”<sup>29</sup>

In contrast, for Representative Peter DeFazio (D-Oregon), waiving the obligation to repay federal grants was “just another example of corporate welfare. The Federal grants amount to a windfall for private investors, at the expense of the U.S. taxpayers.”<sup>30</sup>

The Senate did not address privatization in its version of FAA Reauthorization as many of its leaders, including Commerce Committee Chair John McCain (R-Arizona) and William Ford (D-Kentucky), were unenthusiastic. In addressing the issue on the Senate floor, Senator Ford returned to the issue of revenue diversion: “The conferees were very concerned about the ability to divert revenues under a privatization scheme. However, Los Angeles was the real concern. As a result, we limited the number and type of airports eligible for the pilot program.”<sup>31</sup> House-Senate conferees would ultimately limit the number of airports to five, and designate that only one of the five would be a large hub airport (like Los Angeles International Airport).

The Committee of Conference ultimately arrived at a version of the pilot program that contained many of the features in the House bill, but with some greater controls. The Conference Report provides as follows:

The Managers have agreed to a limited pilot program to determine if new investment and capital from the private sector can be attracted through innovative financial arrangements. The managers spent a great deal of time discussing and debating a series of conditions and limitations. The managers are aware that Allegheny County Airport, a general aviation facility in Pennsylvania, and Stewart Airport in New York State are interested in pursuing these innovative arrangements. The managers anticipate that all airport applications should be appropriately considered and that the Secretary should select airports for this pilot program based on the best qualified candidates.<sup>32</sup>

In addition to limiting the pilot program to five, rather than six, airports, the legislation required USDOT to provide a report to the relevant House and Senate committees within two years on the implementation of the program.<sup>33</sup> While this may have been intended or viewed as a means of limiting the pilot program to two years, the legislation did not provide a sunset or end date for the program.

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<sup>29</sup> Cong. Rec. E1629 (Sept. 17, 1996).

<sup>30</sup> Cong. Rec. H10140 (Sept. 10, 1996).

<sup>31</sup> Cong. Rec. S12232 (Oct. 3, 1996).

<sup>32</sup> H.R. Conf. Report No. 104-848, at 91 (1996).

<sup>33</sup> 49 U.S.C. § 47134(j).

Subsequent floor statements confirmed mixed Congressional support for the pilot program, albeit with greater support in the House than Senate. For example, the Chairman of the House Aviation Subcommittee, Representative John Duncan (R-Tennessee), spoke favorably about the pilot program: “With scarce Federal dollars we need to be looking at new ways of doing things. And I think this pilot program will be very successful just as other privatization efforts have been in several other countries. It will be good for the taxpayers and the flying public.”<sup>34</sup> Representative Bud Shuster (R-Pennsylvania) observed, “This is a pilot program, but I am confident that the success of the program will convince the skeptics that privatization of some airports can be extremely beneficial.”<sup>35</sup>

However, Senator Ernest Hollings (D-South Carolina) took a different twist to Representative DeFazio’s corporate welfare argument, “The provision continues to trouble me. Under the legislation, an airport can be privatized and still receive a Federal grant. If the private sector believes it can suddenly revitalize airports with claims of new money, why does the Federal Government have to provide corporate welfare?”<sup>36</sup>

The General Accounting Office (GAO) supplemented its testimony from the February hearing in a report filed in November 1996, after Congress had enacted the APPP.<sup>37</sup> In it, the GAO examined the issue of private participation in airports generally, not solely focusing on the sale or lease of airports. The report is often cited for its finding that based on a survey of 69 of the nation’s largest airports, 90% of the employees at airports work for private entities, such as airlines, rental car companies, and concessionaires.<sup>38</sup>

The GAO report considered the role of private enterprise in airport management and identified ten specific instances in which an airport owner had considered selling or leasing the airport or a significant airport facility such as a terminal.<sup>39</sup>

Although released after Congress enacted the APPP, the GAO report made the following findings regarding the legal barriers to airport privatization: (1) the prohibition on revenue diversion is “the major obstacle,” (2) the potential requirement to repay past grants or return airport property to the federal government may present an obstacle, (3) noise, environmental and land-use requirements are not significant barriers, (4) safety and security requirements are not significant barriers, and (5) bond covenants may restrict privatization.<sup>40</sup>

## **F.5 Airport Privatization Pilot Program**

The APPP, as enacted in 1996 and amended in 2003, reduced uncertainty about the privatization process and addressed the recognized barriers to privatization by permitting USDOT to grant exemptions from certain federal obligations that historically stymied full privatization. However, Congress required that airports and private operators satisfy demanding conditions in exchange for the exemptions and approvals, including conditions specifically designed to protect its interests and

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<sup>34</sup> Cong. Rec. H11457 (Sept. 27, 1996).

<sup>35</sup> Cong. Rec. E1868 (Sept. 30, 1996).

<sup>36</sup> Cong. Rec. S12233 (Oct. 3, 1996).

<sup>37</sup> U.S. General Accounting Office, *Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports*, GAO/RCED-97-3 (Nov. 1996).

<sup>38</sup> *Id.* at 26-27.

<sup>39</sup> *Id.* at Tbl. 3.1.

<sup>40</sup> *Id.* at 36 – 41.



those of the airport users. The FAA thereafter prescribed detailed procedures for seeking these exemptions and approvals. Viewed as a whole, the APPP today is complex, demanding, and lengthy. This is in part because full privatization transactions are more complicated in general, but also due to the specific legislative requirements imposed by the APPP.

### **F.5.1 49 USC 47134**

The federal law creating the APPP prescribes the following requirements:

1. A general aviation airport may be sold or leased. A commercial service airport may be leased only.<sup>41</sup>
2. Only five airports may receive approval to privatize under the APPP.<sup>42</sup> One of the five airports must be a general aviation airport.<sup>43</sup> No more than one airport may be a large hub primary airport.<sup>44</sup>
3. The Secretary may permit the public airport owner to use sale or lease proceeds for non-airport purposes upon approval (i) in the case of a primary airport, by at least 65% of the scheduled air carriers and by scheduled and unscheduled air carriers accounting for 65% of aircraft landed weight at the airport, and (ii) in the case of a nonprimary airport, by the Secretary after the airport has consulted with at least 65% of the owners of aircraft based at the airport.<sup>45</sup>
4. The Secretary may exempt the public airport owner from any legal requirement to repay prior grants or return airport property to the federal government.<sup>46</sup>
5. The Secretary may permit the private operator to use airport revenue for non-airport purposes in order to “earn compensation from the operations of the airport.”<sup>47</sup>
6. The statute requires that the following nine conditions must be satisfied to obtain approval:
  - a. The airport will continue to be available for public use on reasonable terms and without unjust discrimination.
  - b. The airport will continue to operate in the event the private operator becomes insolvent, seeks bankruptcy protection, or under similar circumstances.
  - c. The private operator will maintain, improve and modernize the airport in accordance with plans submitted to the Secretary.
  - d. Rates and charges on air carriers will not increase faster than the rate of inflation unless a faster increase is approved by at least 65% of the air carriers serving the airport and by air carriers accounting for at least 65% of aircraft landed weight at the airport.
  - e. The fees on general aviation aircraft will not increase faster than the rate of increase for air carriers.

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<sup>41</sup> 49 U.S.C. § 47134(a).

<sup>42</sup> *Id.* § 47134(b).

<sup>43</sup> *Id.* § 47134(d)(1).

<sup>44</sup> *Id.* § 47134(d)(2).

<sup>45</sup> *Id.* § 47134(b)(1)(A).

<sup>46</sup> *Id.* § 47134(b)(2).

<sup>47</sup> *Id.* § 47134(b)(3).

- f. Safety and security at the airport will be maintained at the highest possible levels.
  - g. Noise effects will be mitigated to the same extent as at a public airport.
  - h. Adverse environmental effects will be mitigated to the same extent as at a public airport.
  - i. The sale or lease will not abrogate any collective bargaining agreement covering airport employees.<sup>48</sup>
7. The Secretary must conclude expressly that approving the sale or lease will not result in unfair and deceptive practices or unfair methods of competition.<sup>49</sup>
  8. The Secretary must ensure that the interests of general aviation users at the airport are not adversely affected by the sale or lease.<sup>50</sup>
  9. The private operator will be eligible to impose a Passenger Facility Charge.<sup>51</sup>
  10. The airport will be eligible to receive an apportionment from the Entitlement Fund.<sup>52</sup>
  11. The private operator may impose “reasonable rental charges, landing fees, and other service charges from aircraft operators” consistent with the Anti-Head Tax Act.<sup>53</sup>
  12. The federal share of financial assistance in grants issued from the Discretionary Fund issued to a private operator is 70% of project costs.<sup>54</sup>

### **F.5.2 FAA Application Procedures**

In September 1997, the FAA published detailed procedures for the submission and review of applications to sell or lease an airport in accordance with Section 47134.<sup>55</sup> The application procedures have the following key features:

1. There is a two-step application process, beginning with a preliminary application, which, if accepted for review, will secure an airport’s position as one of the five airports in the APPP. The public airport operator can file a final application once it has selected a private operator. (Note that the public airport operator can submit a final application without first submitting a preliminary application.)
2. The FAA will notify the airport within 30 days whether it has accepted a preliminary application, and thereafter publish notice in the Federal Register that the FAA has accepted the application for review.
3. A preliminary application must include, among other things, a summary of the public airport owner’s objectives in privatizing the airport and a description and timetable for selecting a private operator, including the request for proposals.

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<sup>48</sup> *Id.* § 47134(c).

<sup>49</sup> *Id.* § 47134(c).

<sup>50</sup> *Id.* § 47134(f).

<sup>51</sup> *Id.* § 47134(g)(1).

<sup>52</sup> *Id.* § 47134(g)(2).

<sup>53</sup> *Id.* § 47134(g)(3).

<sup>54</sup> *Id.* § 47109(a). In the initial version of the APPP adopted in 1996, the federal share was 40%. It was increased to 70% by *Vision 100 – Century of Aviation Reauthorization Act of 2003*, Pub. Law No. 108-176, § 163 (2003).

<sup>55</sup> FAA, *Notice of Final Application Procedures, Airport Privatization Pilot Program: Application Procedures*, 62 Fed. Reg. 48693 (1997).

4. The final application is far more detailed and must identify and describe the parties to the transaction, the airport property to be transferred, the terms of the transfer, the qualifications of the private operator, the requests for exemption, a certification of air carrier approval, and plans for the future operation and development of the airport.
5. To enable USDOT to determine whether certain statutory conditions will be satisfied, USDOT requires information in the final application necessary to conduct a fitness test on the private operator (e.g., experience, financial resources, etc.).
6. USDOT will solicit public comment on a final application.
7. USDOT's approval or rejection of an application and specific exemptions is contained in a Record of Decision.

*Foreign Investment* – In addition to the FAA application procedures, it is possible that the sale or lease of an airport to a private operator that is a foreign entity may be subject to investigation by the Committee on Foreign Investment in the United States (“CFIUS”).<sup>56</sup> An investigation may be initiated by the President, by the CFIUS, or based on voluntary notice of the intended transaction to the CFIUS. The President can prohibit the transfer upon finding that the foreign interest threatens to impair national security. Alternatively, the CFIUS can impose conditions to mitigate an identified threat. The CFIUS is concerned principally with transactions by which a U.S. business would become controlled directly or indirectly by a foreign government.

### **F.5.3 FAA Decisions Under the APPP**

As detailed elsewhere in this Guidebook, only one airport has received approval from FAA to privatize under the APPP: Stewart International Airport in Newburgh, New York. FAA approved the State of New York's final application in February 2000. FAA's findings, statements, and determinations in the Record of Decision provide important guidance on the agency's interpretation of Section 47134 and, equally important, present an image of the legal structure of an airport that has privatized under the APPP.

The following is a summary of the key elements of the agreement and key FAA determinations in approving New York State's application:

1. The State of New York Department of Transportation (“NYSDOT”) leased the airport to SWF Airport Acquisition, Inc. (“SWFAA”), a wholly-owned subsidiary of National Express Corporation, for a period of 99 years. The lease included an industrial park but excluded an Air National Guard Base and an area that was the subject of environmental remediation.
2. SWFAA agreed to pay \$35 million, in a series of initial payments, to lease the airport, and rent payments reflecting 5% of gross income beginning after Year 10 or once total passenger traffic reached 1,380,000.
3. NYSDOT did not obtain the requisite approval by air carriers operating at the airport necessary to exempt NYSDOT from the prohibition on revenue diversion. However, the State was able to document that it had made loans to the airport within the preceding 6 years

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<sup>56</sup> See 50 U.S.C. § 2170. See also Dept. of Treasury, Final Rule, *Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons*, 73 Fed. Reg. 70716 (2008); Dept. of Treasury, Notice, *Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States*, 73 Fed. Reg. 74567 (2008).

totaling nearly \$25 million. The FAA required that the remainder of the initial lease payment and future percentage rent payments must be used exclusively for airport purposes.

4. FAA, with limited discussion, waived any requirement that NYSDOT repay prior grants or return property conveyed by the federal government, seemingly on the basis that the property would continue to be used as an airport.
5. FAA granted an exemption to SWFAA from the prohibition on revenue diversion permitting SWFAA to reap a return on investment of between 3% and 35%. However, FAA conditioned its approval on SWFAA *first* meeting its obligations for investment in the airport before it could realize any return on investment.
6. FAA released NYSDOT from its status as airport sponsor and transferred responsibility for compliance with the grant assurances to SWFAA. However, FAA required NYSDOT to remain primarily responsible for certain grant assurances, particularly including Assurance 4 (Good Title), Assurance 20 (Hazard Removal and Mitigation), Assurance 21 (Compatible Land Use), Assurance 31 (Disposal of Land) and Assurance 35 (Relocation of Real Property). NYSDOT further agreed to reassume primary responsibility for grant assurance compliance in the event SWFAA defaulted under the lease.
7. While a portion of the airport had been conveyed from the federal government pursuant to the successor statute to the Surplus Property Act, FAA determined that it was not necessary to grant an exemption from the Surplus Property Act. FAA did revise certain terms of the original deed so as to permit NYSDOT to lease the airport to a private operator. FAA did not declare explicitly whether it was relieving NYSDOT from its primary responsibility to ensure compliance with the deed restrictions.
8. NYSDOT and SWFAA agreed to confer third party beneficiary rights to FAA under the lease, enabling FAA to enforce the APPP conditions.
9. FAA concurrently issued an Airport Operating Certificate to SWFAA and approved SWFAA's proposed security plan (under the former security regulations overseen by FAA).

#### **F.5.4 Congressional Reconsideration of the APPP**

- *Congressional Hearing (1999)* – On June 30, 1999, the House Aviation Subcommittee held a hearing to consider the status of airport privatization. The Subcommittee received testimony from BAA USA, the Empire State Development Corporation, Diversified Asset Management Group, and the FAA. All parties recognized the limited level of privatization under the APPP; however, panelists testified as to the then-pending plans to privatize Stewart International Airport and San Diego Brown Field.
- *Amendments to APPP (2003)* – In *Vision 100 – Century of Aviation Reauthorization Act of 2003*, Congress made the following three changes to the APPP: (1) USDOT could exempt a non-primary airport from the prohibition on revenue diversion upon finding that the public airport operator consulted with a minimum of 65% of the owners of based aircraft; (2) air carriers have only 60 days to approve or object to a requested exemption from the prohibition on revenue diversion; and (3) the federal share for AIP discretionary grants was increased to 70%.
- *Report to Congress (2004)* – In August 2004, FAA submitted a report to Congress as required by Section 47134. FAA found that “it is too early to conclude whether privatization of

airports in the United States under the pilot program can result in access to new sources of capital for airport development and improvements in customer service.”<sup>57</sup> FAA did review the status of each application filed under the APPP and reported favorably on the privatization of Stewart International Airport, which received USDOT approval in 2000. FAA also identified common characteristics of the applicants, including: airport management was secondary or one of many responsibilities of the owner; the airports were underutilized and subsidized by the sponsoring government entity; the federal and local processes for pursuing privatization were long and time consuming; the private operators proposed to use a limited liability corporation to manage the airport; and success depended in part on strong political commitment.

- *Bush Administration (2007)* - In 2007, the Bush Administration proposed to amend the APPP through FAA Reauthorization. Although never acted upon, the proposal would have further reduced barriers to full privatization by, for example, increasing the number of airports eligible to participate in the APPP from 5 to 15, eliminating the requirement for air carrier approval to use sale or lease proceeds for non-airport purposes, eliminating certain conditions on USDOT approval, and eliminating the requirements as to the type of airports that are eligible to participate in the APPP.<sup>58</sup>
- *FAA Reauthorization (2011)* – In April 2011, the House and Senate passed their versions of FAA Reauthorization. The House bill (H.R. 658, FAA Air Transportation Modernization and Safety Improvement Act) would make significant changes to the APPP, while the Senate version would make no changes to current law. The House bill would:
  - Double the number of slots in the pilot program from five to ten and eliminate any set asides for use of any of the ten slots
  - Transform the 65% air carrier and general aviation user approval requirement for the revenue use exemption to a consultation requirement
  - Eliminate the protection for collective bargaining agreements
  - Strike the limitations on air carrier and general aviation fee increases
  - Add a provision that “a fee imposed by the airport on an air carrier or foreign air carrier may not include any portion for a return on investment or recovery of principal with respect to consideration paid to a public agency for the lease or sale of the airport unless that portion of the fee is approved by the air carrier or foreign air carrier”

Taken together, the House changes would significantly change the APPP and could lead to additional participation by airports. Given the bicameral disagreements, the competing House and Senate language would almost certainly be resolved in a conference committee between the two chambers. While the Senate appointed conferees in May 2011, the House has not appointed conferees as of December 2011.

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<sup>57</sup> FAA, *Report to Congress on the Status of the Airport Privatization Pilot Program*, United States Code, Title 49, Section 47134, at 2 (2004).

<sup>58</sup> *Next Generation Air Transportation System Financing Reform Act of 2007*, § 806.

## F.6 Privatization Outside the Pilot Program

Privatization can encompass a wide range of strategies, from privatizing particular airport functions such as the management of a terminal or even the entire airport operation, to privatizing the ownership of the airport with the long-term lease of a commercial service airport. The receipt of AIP and the explicit acceptance of grant assurances mean that an airport owner has effectively two alternatives to privatize: (1) retain sponsorship and privatize limited functions and/or facilities (partial privatization), and (2) transfer sponsorship, along with primary decision-making authority over the airport, to a private entity (full privatization). Full privatization itself has two sub-sets: (i) full privatization through the APPP or (ii) full privatization outside of the APPP. A private airport developer building on a green-field site without federal assistance is not privatizing *per se* and represents a distinct type of airport owner in the U.S.<sup>59</sup>

### F.6.1 Rules for Sale or Lease Outside Pilot Program

Since 1996, no public airport operator has sought to sell or lease an airport to a private operator outside of the APPP. However, this option remains available, and may be pursued in the event that either all the available slots in the APPP program are encumbered, or if an owner chooses to do so without the regulatory boundaries of the APPP. FAA has not published guidance specifically on this subject; however, FAA provided some guidelines in the *Airport Compliance Manual*, released in September 2009.<sup>60</sup>

Privatizing outside the APPP has the following attributes:

1. FAA approval is required.
2. FAA will review a request to transfer an airport to a private operator in a similar fashion to its review of a request to transfer an airport to another public entity.
3. FAA may require the public airport operator to maintain concurrent responsibility for certain grant assurances, such as the obligations concerning compatible land use and hazards to air navigation.
4. FAA will not approve an application without a commitment by the private operator to assume responsibility for the grant assurances and any Surplus Property Act deed restrictions.
5. FAA will not exempt the public airport operator from the prohibition on revenue diversion, but may permit the private operator to recover its initial investment and receive compensation for managing the airport.
6. FAA may not require repayment for the value of grant-funded projects and land transferred by the federal government.
7. The private operator will not be eligible for an apportionment from the Entitlement Fund.
8. The private operator will be required to obtain a separate Airport Operating Certificate and to prepare an Airport Security Program.

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<sup>59</sup> The four are (1) public sponsors receiving AIP; (2) APPP airports; (3) privatized airports outside of the APPP; and (4) privately developed airports that have never received federal assistance.

<sup>60</sup> FAA Order 5190.6B, *Airport Compliance Manual*, § 6.15 (Privatization Outside of the Airport Privatization Pilot Program) (Sept. 2009).

In a recent article, former FAA official David Bennett argues that public owners of airports would be better off privatizing outside of the APPP if they are not seeking to divert revenue, defined as using the proceeds from a lease or sale for non-airport purposes. The potential benefits include removing the responsibility from operating an airport, having the airport developed by a private entity that may find new business opportunities that the public owner could not, and using the proceeds from a sale of the local airport to invest in other airports operated by the owner, something explicitly permitted by grant assurance 25.<sup>61</sup>

### **F.6.2 Rules for Management Contracts, Developer Financing Agreements, Service Contracts, etc.**

The FAA's *Airport Compliance Manual* contains important guidance on certain forms of partial privatization, particularly including management contracts.<sup>62</sup>

1. A public airport operator may contract with an agent to perform airport management or other administrative and supervisory functions. This arrangement may be defined in a management contract, lease or both.
2. The public airport operator remains the airport sponsor, and therefore is responsible for compliance with all grant assurances and other federal obligations. (Note that the difference between full and partial privatization in the instance of a lease of an entire airport is whether the public airport operator continues to be the airport sponsor.)
3. FAA strongly encourages public airport owners to execute separate agreements for airport management functions and aeronautical activities to be conducted by the private entity.
4. FAA recommends that a management agreement include particular terms requiring that the private entity to conduct its activities consistent with the grant assurances and other federal obligations imposed on the public airport operator and that the management agreement itself be subordinate to the grant assurances.

### **F.6.3 Rules for Private Airport Developer**

As indicated above, the direct and indirect federal controls on airports largely are the result of federal financial assistance to the airport. The legal structure applicable to an airport developed on a green-field site by a private entity without federal financial assistance is dramatically different. The private developer/operator would not be constrained by the grant assurances, statutory requirements applicable only to public entities (e.g., the AHTA), and statutory requirements applicable to entities that have received federal assistance at some point in the past (e.g., the statutory prohibition on revenue diversion found at 49 U.S.C. § 47133). Further, while it is possible that a private airport developer/operator would be deemed a "state actor" responsible for guaranteeing the rights and protections afforded by the U.S. Constitution (e.g., on the basis that operating a public-use airport is a public function), private airport developers/operators are the least likely to be deemed bound by the U.S. Constitution.

Freed from these constraints, a private developer/operator could, for example, do the following:

1. Impose user fees directly on passengers.<sup>63</sup>

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<sup>61</sup> David L. Bennett, *Airport Privatization After Midway*, *The Air & Space Lawyer* v.23, (2010).

<sup>62</sup> FAA Order 5190.6B, § 6.13 (Airport Management Agreements).

2. Permit only certain air carriers to serve the airport.
3. Divert revenue from the airport.

At the same time, a private developer/operator would not enjoy several of the protections afforded government entities. In particular, the private developer/operator would not be eligible for state constitutional and statutory exemptions from property taxation, and would not enjoy state action immunity from liability under the federal anti-trust statutes.

## **F.7 Lessons Learned**

With respect to full privatization, the APPP was created as a political compromise, negotiated among several public and private interests that sought an alternative to the traditional FAA model. It decidedly was *not* a decision to permit state and local governments to turn over airports entirely to private enterprise free from federal oversight. Airports are not only regulated under the APPP, as private airports are in other nations, but they retain eligibility for airport capital grants under AIP and they have to abide by many of the most important grant assurances imposed as part of their previous receipt of AIP funds. At least in the case of the long-term lease of a commercial service airport, the public entity remains concurrently responsible for certain grant assurances and other federal obligations. It may be argued that this is not privatization in its pure form but rather a half-measure by which the private operator takes on the role of airport owner in something akin to the traditional form, including both the financial support and regulatory burdens. Seen in this context, the APPP represents a “toe in the water” for privatization, one which remains heavily circumscribed within the regulatory structure of USDOT and the FAA and one affording protection to the airport’s most important tenants, the airlines and general aviation.

Viewing the APPP in this way also affects the relative merit of full privatization outside of the APPP, private airport development, and partial privatization. Privatizations under the APPP and outside the APPP both entail the transfer of sponsorship obligations to a private operator. The principal benefit of going through the lengthy application process under the APPP is the potential for an exemption from the prohibition on revenue diversion. Private airport development without federal assistance constitutes the only permissible means of operating an airport free of the grant assurances and other federal obligations.

Partial privatization remains the most common form of enlisting private participation in large part because it presents a far easier way for private entities to realize profits from their airport activities and because it reflects the serious challenges faced by any public airport owner that wishes to transfer or avoid its federal obligations.

Compared to other airport privatizations worldwide, the U.S. experience has been decidedly a modest one. That should not be surprising since the movement to privatize infrastructure is just over two decades old in the U.S. In addition, privatization is not yet a widely accepted solution for policymakers seeking to solve the problem of under-investment in infrastructure, especially airport infrastructure. Instead, policymakers have over the last two decades offered airport owners a wide

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<sup>63</sup> In considering the legality of an “airport facility charge” imposed by the private operator of the Branson Airport, DOT found that neither the AHTA nor the PFC statute applied, since the airport operator was not a public entity, but reserved judgment on whether the “reasonableness” requirement of 49 U.S.C. § 47129 applies to a private airport operator. Letter from S. Podberesky, DOT, to G. Wicks re: Branson Airport’s Airport Facility Charge Request at (Jan. 16, 2009).



range of benefits, including capital grants, a mechanism to charge passengers independent of airport-airline use and lease agreements, and federal tax subsidies. It is no wonder that U.S. airports have opted to take full advantage of these benefits.

Table F.1 presents a summary of the legal incentives and disincentives under partial and full privatization.

**Table F.1. Summary of Incentives/Disincentives to Partial and Full Privatization**

<b>Issue</b>	<b>Partial Privatization</b>	<b>Full Privatization</b>
FAA Approval	May or may not be needed, depending on structure and terms	Necessary and can deter
Revenue Use	Not a barrier	Requires express exemption
Grant Eligibility	Public entity remains sponsor and eligible	Entitlements only available through APPP; lower discretionary federal share for airports in APPP
Grant Repayment	n.a.	Not required if remains an airport
Control over Aeronautical Activities	Subject to grant assurances and AHTA standards	Under APPP, subject to caps, grant assurances, and AHTA reasonableness standard Outside APPP subject to grant assurances
Control over Non-aeronautical activities	Viable revenue source resulting from flexibility to control rates	Viable revenue source resulting from flexibility to control rates

In the next section, the last 15 years of the APPP and the FAA airports’ program are reviewed with an eye toward understanding the decision of whether or not an airport owner should opt to participate in the APPP. This choice is fundamental and unique to the U.S. experience.

## **F.8 Frequently Asked Legal Questions About Full Airport Privatization**

The following is a short summary – in the form of questions and answers – concerning the principal legal issues presented by full airport privatization within and outside of the APPP. The underlying source material (statutes, regulations, guidance, etc.) is provided in Appendix F.2.

### ***Question #1 – Is FAA approval required for sale or lease to a private operator?***

Yes. The sale or lease of an airport to a private operator, within or outside of the APPP, requires FAA approval.

### ***Question #2 – What conditions apply to FAA’s consideration of a request to sell or lease an airport to a private operator?***

Airports participating in the APPP must satisfy nine conditions prescribed by Section 47134. For privatization outside the APPP, the FAA requires that private operators agree to assume responsibility for the grant assurances, Surplus Property Act deed restrictions and other federal obligations. The FAA has not indicated what other conditions might apply to privatization outside of the APPP.

### ***Question #3 - Is the public airport owner or the private operator responsible for compliance with the grant assurances upon transfer?***

For privatization within or outside the APPP, the private operator will be responsible for compliance with the grant assurances, at least for so long as the grant assurances might otherwise remain applicable. Also, FAA may require that the public airport operator in either circumstance concurrently maintain responsibility for certain grant assurances.

### ***Question #4 – Will sale or lease proceeds constitute “airport revenue”?***

Yes. Sale or lease proceeds to any private owner will constitute airport revenue. However, an applicant under the APPP can request an exemption permitting the public airport owner to use sale or lease proceeds for non-airport purposes (see next question).

***Question #5 – What restrictions apply to a public airport owner’s use of sale or lease proceeds?***

Under the APPP, the Secretary may grant an exemption permitting the public airport owner to use sale or lease proceeds for non-airport purposes upon approval by 65% of air carriers, by number and landed weight, at a primary airport, and upon consultation with 65% of based aircraft at all other airports. If the applicant does not seek or obtain consent or conduct the required consultation, and for airports privatizing outside the APPP, the public airport owner is required to use sale or lease proceeds for airport purposes.

***Question #6 – Is a public airport owner required to reinvest or repay the federal government when selling or leasing property acquired with “federal assistance”?***

Section 47134 explicitly permits USDOT to excuse any reinvestment or repayment obligation. In 2009, the FAA clarified that public airport operators privatizing outside the APPP will not have to reinvest or repay prior grants so long as the airport continues to be made available for public use.

***Question #7 – Is a public airport owner permitted to use sale or lease proceeds to repay the General Fund for prior contributions to the airport?***

Yes. Whether or not privatizing under the APPP and whether or not a public airport operator receives approval by air carriers, the public airport operator can repay loans made by the sponsoring government within the preceding six years and repay loans pursuant to written obligations regardless of the date of the agreement.

***Question #8 – What restrictions apply to a private operator’s use of revenue generated from the airport?***

Section 47134 permits USDOT to grant an exemption from the prohibition on revenue diversion “to the extent necessary to permit the purchaser or lessee to earn compensation from the operations of the airport.” FAA guidance indicates that a private operator acting outside of the APPP would be subject to all of the grant assurances, presumably including the prohibition on revenue diversion. However, the FAA has acknowledged that a private operator may have a limited right to recover its initial investment and earn some measure of compensation for managing the airport.

***Question #9 – What restrictions apply to a private operator’s imposition of rates and charges?***

Section 47134 limits increases in fees imposed on air carriers to the rate of inflation unless higher increases are approved by 65% of air carriers (by number and landed weight), and limits the percentage increase in fees to General Aviation to the percentage increase charged to air carriers. While not subject to the AHTA’s requirement that rates and charges be “reasonable,” a private operator outside of the APPP would be subject to the reasonableness and unjust discrimination standards imposed by the grant assurances and may be subject to other requirements of the FAA Policy Regarding Airport Rates and Charges.

***Question #10 – Is a private operator eligible for apportionment from the AIP Entitlement Fund?***

Section 47134 explicitly authorizes a private operator to receive an apportionment from the Entitlement Fund. Private operators acting outside the APPP are not eligible for an apportionment.

***Question #11 – Is a private operator eligible for grants from the AIP Discretionary Fund?***

Section 47109 provides that the federal share for discretionary grants for airports privatized under the APPP shall be 70%. Private operators outside the APPP may be eligible for discretionary grants if the airport is a reliever airport or receives 2,500 annual passenger boardings.

***Question #12 – Is a private operator authorized to impose a Passenger Facility Charge?***

Section 47134 explicitly authorizes a private operator to impose a Passenger Facility Charge under the APPP. While private operators acting outside the APPP technically are not eligible to impose a Passenger Facility Charge, private operators may impose charges on enplaning passengers, because the Anti-Head Tax Act, to which the PFC statute is an exception, does not apply to private entities.

***Question #13 – Is a private operator required to separately obtain an Airport Operating Certificate?***

Yes. A private operator, within or outside the APPP, is required to request, secure, and maintain an Airport Operating Certificate pursuant to FAR Part 139 if the aeronautical activity at the airport demands a certificate.

***Question #14 – Is a private operator required to maintain an Airport Security Program?***

Yes. A private operator, within or outside the APPP, is required to maintain an Airport Security Program, depending on the nature and type of commercial passenger service.

***Question #15 – Is the public airport owner or the private operator obligated to provide law enforcement at the airport upon transfer?***

A private airport operator, within or outside the APPP, must provide law enforcement personnel or ensure that law enforcement personnel are available to respond to an incident, depending on the type of Airport Security Program in place at the airport.

## Appendix F.1

### Acronyms

<b>AAIA</b>	Airport and Airway Improvement Act of 1982
<b>AHTA</b>	Anti-Head Tax Act
<b>AIP</b>	Airport Improvement Program
<b>APPP</b>	Airport Privatization Pilot Program
<b>BALLAT</b>	British American Ltd. and Lockheed Air Terminal
<b>CFIUS</b>	Committee on Foreign Investment in the United States
<b>DOJ</b>	U.S. Department of Justice
<b>FAA</b>	Federal Aviation Administration
<b>GAO</b>	General Accounting Office, now the General Accountability Office
<b>NYSDOT</b>	State of New York Department of Transportation
<b>PFCs</b>	Passenger Facility Charges
<b>SWFAA</b>	SWF Airport Acquisition, Inc.
<b>USDOT</b>	U.S. Department of Transportation

## **Appendix F.2**

### **LEGAL ISSUES IN AIRPORT PRIVATIZATION: COMPILATION OF STATUTES, REGULATIONS AND GUIDANCE**

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**LEGAL ISSUES IN AIRPORT PRIVATIZATION:**

**COMPILATION OF STATUTES, REGULATIONS AND GUIDANCE**

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**LEGAL ISSUES IN AIRPORT PRIVATIZATION:  
COMPILATION OF STATUTES, REGULATIONS AND GUIDANCE**

<b>IS FAA APPROVAL REQUIRED FOR SALE OR LONG-TERM LEASE TO A PRIVATE OPERATOR?</b>	
<b>GENERAL LEGAL STANDARD</b>	<p><i>Grant-Obligated Airports</i> – “[The airport sponsor] will not sell, lease, encumber or otherwise transfer or dispose of any part of its title or other interests in the property shown on Exhibit “A” to this [grant] application or, for a noise compatibility program project, that portion of the property upon which federal funds have been expended, for the duration of the terms, conditions, and assurances in the grant agreement without approval by the Secretary.”<sup>64</sup></p> <p><i>Surplus Property Act Airports</i> – “A State, political subdivision of a State, or tax-supported organization receiving the interest may use, lease, salvage, or dispose of the interest for other than airport purposes only after the Secretary of Transportation gives written consent that the interest can be used, leased, salvaged, or disposed of without materially and adversely affecting the development, improvement, operation, or maintenance of the airport at which the property is located.”<sup>65</sup></p> <p>“Although surplus property instruments permit the conveyance to a third party, the sponsor must obtain FAA approval prior to its transfer, and the transferee must assume the federal obligations of the original grantee. In addition, a release deed will also be required.”<sup>66</sup></p>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	<p>“If a sponsor intends to sell or lease a general aviation airport or lease any other type of airport for a long term to a person (other than a public agency), the sponsor and purchaser or lessee may apply to the Secretary of Transportation for exemptions under this section.”<sup>67</sup></p>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>“Sale or lease of a public airport to a private airport operator is not prohibited by law, and the FAA may be requested to approve a transfer of ownership or operating responsibility of a public airport to a private operator without an application for participation in the airport privatization pilot program.”<sup>68</sup></p>

<sup>64</sup> Grant Assurance 5(b).

<sup>65</sup> 49 U.S.C. § 47152(1).

<sup>66</sup> FAA Order 5190.6B, *Airport Compliance Manual*, § 6.7(b) (2009).

<sup>67</sup> 49 U.S.C. § 47134(a).

<sup>68</sup> FAA Order 5190.6B, § 6.15(a).



**WHAT CONDITIONS APPLY TO FAA CONSIDERATION OF REQUEST TO SELL OR LEASE AN AIRPORT TO A PRIVATE OPERATOR?**

<p><b>GENERAL LEGAL STANDARD</b></p>	<p><i>Grant-Obligated Airports</i> – “Before a transfer to another entity can take place, the FAA must specifically determine the recipient is eligible and willing to perform all the conditions of the grant agreements. Otherwise, the FAA will not permit the transfer to occur.”<sup>69</sup></p> <p><i>Surplus Property Act Airports</i> – “A total release permitting the sale and disposal of real property acquired for airport purposes under the Surplus Property Act shall not be granted unless it can be clearly shown that the disposal of such property will benefit civil aviation.”<sup>70</sup></p>
<p><b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b></p>	<p>“The Secretary may approve an application under subsection (b) only if the Secretary finds that the sale or lease agreement includes provisions satisfactory to the Secretary to ensure the following:</p> <ol style="list-style-type: none"> <li>(1) The airport will continue to be available for public use on reasonable terms and conditions and without unjust discrimination.</li> <li>(2) The operation of the airport will not be interrupted in the event that the purchaser or lessee becomes insolvent or seeks or becomes subject to any State or Federal bankruptcy, reorganization, insolvency, liquidation, or dissolution proceeding or any petition or similar law seeking the dissolution or reorganization of the purchaser or lessee or the appointment of a receiver, trustee, custodian, or liquidator for the purchaser or lessee or a substantial part of the purchaser or lessee’s property, assets or business.</li> <li>(3) The purchaser or lessee will maintain, improve, and modernize the facilities of the airport through capital investments and will submit to the Secretary a plan for carrying out such maintenance, improvements, and modernization.</li> <li>(4) Every fee of the airport imposed on an air carrier on the date before the date of the lease of the airport will not increase faster than the rate of inflation unless a higher amount is approved – (A) by at least 65 percent of the air carriers serving the airport; and (B) by air carriers whose aircraft landing at the airport during the preceding calendar year had a total landed weight during the preceding calendar year of at least 65 percent of the total landed weight of all aircraft landing at the airport during such year.</li> <li>(5) The percentage increase in fees imposed on general aviation aircraft at the airport will not exceed the percentage increase in fees imposed on air carriers</li> </ol>

<sup>69</sup> FAA Order 5190.6B, § 6.7(a).

<sup>70</sup> FAA Order 5190.6B, § 22.17(a). *See also* 49 U.S.C. § 47153.

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	<p>at the airport.</p> <p>(6) Safety and security at the airport will be maintained at the highest possible levels.</p> <p>(7) The adverse effects of noise from operations at the airport will be mitigated to the same extent as at a public airport.</p> <p>(8) Any adverse effects on the environment from airport operations will be mitigated to the same extent as at a public airport.</p> <p>(9) Any collective bargaining agreement that covers employees of the airport and is in effect on the date of the sale or lease of the airport will not be abrogated by the sale or lease.”<sup>71</sup></p>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>“The transfer will not be approved unless the private operator agrees to assume all of the existing obligations of the public sponsor under grant agreements and surplus and nonsurplus property deeds.”<sup>72</sup></p>

<sup>71</sup> 49 U.S.C. § 47134(c).

<sup>72</sup> FAA Order 5190.6B, § 6.15(c)(1).

<b>IS THE PUBLIC AIRPORT OWNER OR THE PRIVATE OPERATOR RESPONSIBLE FOR COMPLIANCE WITH THE GRANT ASSURANCES UPON TRANSFER?</b>	
<b>GENERAL LEGAL STANDARD</b>	<p>“As a condition of release, the FAA will require the new operator to assume all existing grant obligations, and the FAA will review the transfer document to ensure there is no ambiguity regarding responsibility for the federal obligations.”<sup>73</sup></p> <p>“If the transferee is found by the Secretary to be eligible under Title 49, United States Code, to assume the obligations of the grant agreement and to have the power, authority, and financial resources to carry out all such obligations, the sponsor shall insert in the contract or document transferring or disposing of the sponsor’s interest, and make binding upon the transferee all of the terms, conditions, and assurance contained in this grant agreement.”<sup>74</sup></p> <p>“If an arrangement is made for management and operation of the airport by any agency or person other than the sponsor or an employee of the sponsor, the sponsor will reserve sufficient rights and authority to insure that the airport will be operated and maintained in accordance [with] Title 49, United States Code, the regulations and the terms, conditions and assurances in the grant agreement and shall insure that such arrangement also requires compliance therewith.”<sup>75</sup></p>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	<p>“The following statements and information must be included in the final application.</p> <p>...</p> <p>Part VII (Airport Operation and Development)</p> <p>...</p> <p>(B) The private operator’s acceptance of the grant assurances contained in the public sponsor’s grant agreements with the FAA.”<sup>76</sup></p> <p>“As a result of the transfer, the public sponsor should not be obligated for the airport grant assurances assumed by the private operator. However, the public sponsor may continue to have Federal obligations under the exemption approval. These Federal obligations may depend on: (1) The conditions of exemption; (2) third party beneficiary rights; and (3) specific terms of the transfer agreement.”<sup>77</sup></p>

<sup>73</sup> FAA Order 5190.6B, § 6.7(a).

<sup>74</sup> Grant Assurance 5(b).

<sup>75</sup> Grant Assurance 5(f).

<sup>76</sup> FAA, *Notice of Final Application Procedures*, 62 Fed. Reg. 48693, 48708 (1997).

<sup>77</sup> 62 Fed. Reg. at 48700.

	<p>“These leases and sales [under the APPP] also transfer the federal obligations to the private operator, although the FAA may require the public agency transferring the airport to retain concurrent responsibility for certain assurances if appropriate.”<sup>78</sup></p>
<p><b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b></p>	<p>“The transfer will not be approved unless the private operator agrees to assume all of the existing obligations of the public sponsor under grant agreements and surplus and nonsurplus property deeds. For future grants, the private operator will agree to the assurances applicable to a private operator, but initially will also be obligated to comply with the public operator’s assurances as long as they would have remained in effect for the public operator.”<sup>79</sup></p> <p>“As with transfers under the privatization pilot program, the FAA may require the public agency transferring the airport to retain concurrent responsibility for certain assurances if appropriate. For example, FAA may require a transferring public agency to maintain its ability to use its local zoning power to protect approaches to the airport.”<sup>80</sup></p> <p>Note: While there are some differences in the Grant Assurances applicable to public and private sponsors, several key Assurances apply equally to public and private sponsors, including without limitation: Assurance 19 (Operation and Maintenance), Assurance 22 (Economic Nondiscrimination), Assurance 23 (Exclusive Rights), Assurance 24 (Fee and Rental Structure) and Assurance 25 (Airport Revenues).</p>

<sup>78</sup> FAA Order 5190.6B, § 6.14(b).

<sup>79</sup> FAA Order 5190.6B, § 6.15(c)(1).

<sup>80</sup> FAA Order 5190.6B, § 16.15(b).

<b>WILL SALE OR LEASE PROCEEDS CONSTITUTE “AIRPORT REVENUE”?</b>	
<b>GENERAL LEGAL STANDARD</b>	<p>“All fees, charges, rents or other payments received by or accruing to the sponsor for any one of the following reasons are considered to be airport revenue: a. Revenue from air carriers, tenants, lessees, purchasers of airport properties, airport permittees making use of airport property and services, and other parties. Airport revenue includes all revenue received by the sponsor for the activities of others or the transfer of rights to others relating to the airport, including revenue received: . . . (ii) For the sale, transfer, or disposition of airport real property (as specified in the applicability section of this policy statement) not acquired with Federal assistance or personal airport property not acquired with Federal assistance, or any interest in that property, including transfer through a condemnation proceeding.”<sup>81</sup></p>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	<p>49 U.S.C. § 47134 does not re-characterize sale or lease proceeds as anything other than airport revenue. Instead, Section 47134(b) provides opportunity to seek and receive exemption from federal requirements on the use of airport revenue. (See below.)</p>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>General rule applies. Sale or lease proceeds are airport revenue.</p>

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<sup>81</sup> FAA, *Policy and Procedures Concerning the Use of Airport Revenue*, § II(B)(1), 64 Fed. Reg. 7696, 7716 (1999).

**WHAT RESTRICTIONS APPLY TO PUBLIC AIRPORT OWNER'S USE OF SALE OR LEASE PROCEEDS?**

<p><b>GENERAL LEGAL STANDARD</b></p>	<p>“The Secretary of Transportation may approve a project grant application under this subchapter for an airport development project only if the Secretary receives written assurances, satisfactory to the Secretary, that local taxes on aviation fuel (except taxes in effect on December 30, 1987) and the revenues generated by a public airport will be expended for the capital or operating costs – (A) the airport; (B) the local airport system; or (C) other local facilities owned or operated by the airport owner or operator and directly and substantially related to the air transportation of passengers or property.”<sup>82</sup></p> <p>“Local taxes on aviation fuel (except taxes in effect on December 30, 1987) or the revenues generated by an airport that is the subject of Federal assistance may not be expended for any purpose other than the capital or operating costs of – (1) the airport; (2) the local airport system; or (3) any other local facility that is owned or operated by the person or entity that owns or operates the airport that is directly and substantially related to the air transportation of passengers or property.”<sup>83</sup></p>
<p><b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b></p>	<p>“The Secretary may grant an exemption to a sponsor from the provisions of sections 47107(b) and 47133 of this title (and any other law, regulation, or grant assurance) to the extent necessary to permit the sponsor to recover from the sale or lease of the airport such amount as may be approved – (i) in the case of a primary airport, by at least 65 percent of the scheduled air carriers serving the airport and by scheduled and nonscheduled air carriers whose aircraft landing at the airport during the preceding calendar year, had a total landed weight during the preceding calendar year of at least 65 percent of the total landed weight of all aircraft landing at the airport during such year; or (ii) in the case of a nonprimary airport, by the Secretary after the airport has consulted with at least 65 percent of the owners of aircraft based at that airport, as determined by the Secretary.”<sup>84</sup></p>

<sup>82</sup> 49 U.S.C. § 47107(b)(1).

<sup>83</sup> 49 U.S.C. § 47133(a).

<sup>84</sup> 49 U.S.C. § 47134(b)(1)(A).

<p><b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b></p>	<p>“In its review of such a proposal [to privatize outside the APPP], the FAA would condition its approval of the transfer on the parties’ assurances that the proceeds of sale will be used for the purposes permitted by the revenue-use requirements of 49 U.S.C. §§ 47107(b) and 47133.”<sup>85</sup></p> <p>“The FAA may not exempt the public sponsor from the requirements of Grant Assurance 25, <i>Airport Revenues</i>. Accordingly, the public sponsor may use the proceeds from the sale or lease of the airport only for purposes stated in 49 U.S.C. § 47107(b) and § 47133.”<sup>86</sup></p>
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<sup>85</sup> *Policy and Procedures Concerning the Use of Airport Revenue*, § III(C)(3), 64 Fed. Reg. at 7717.

<sup>86</sup> FAA Order 5190.6B, § 6.15(c)(2).

**IS A PUBLIC AIRPORT OWNER REQUIRED TO REINVEST OR REPAY FEDERAL GOVERNMENT WHEN SELLING OR LEASING PROPERTY ACQUIRED WITH “FEDERAL ASSISTANCE”?**

<p><b>GENERAL LEGAL STANDARD</b></p>	<p><i>Land Acquired Through Surplus Property Act</i> – “The Administrator does not issue a release under this part if it would allow the sale of the property concerned to a third party, unless the public agency concerned has obligated itself to use the proceeds from the sale exclusively for developing, improving, operating, or maintaining a public airport.”<sup>87</sup></p> <p><i>Land Acquired for Airport Development</i> - “The Secretary of Transportation may approve an application under this subchapter for an airport development project grant only if the Secretary receives written assurances, satisfactory to the Secretary, that if an airport owner or operator has received or will receive a grant for acquiring land and – (B) if the land was or will be acquired for an airport purpose (except a noise compatibility purpose) - . . . (iii) the part of the proceeds from disposing of the land that is proportional to the Government’s share of the cost of acquiring the land will be reinvested, on application to the Secretary, in another eligible airport development project the Secretary approves under this subchapter or paid to the Secretary for deposit in the [Airport and Airway Trust] Fund if another eligible project does not exist.”<sup>88</sup></p> <p><i>Land Acquired for Noise Compatibility</i> – “(A) if the land was or will be acquired for a noise compatibility purpose - . . . (iii) the part of the proceeds from disposing of the land that is proportional to the Government’s share of the cost of acquiring the land will be paid to the Secretary for deposit in the Airport and Airway Trust Fund established under section 9502 of the Internal Revenue Code of 1986 (26 U.S.C. 9502) or, as the Secretary prescribes, reinvested in an approved compatibility project, including the purchase of nonresidential buildings or property in the vicinity of residential buildings or property previously purchased by the airport as part of a noise compatibility program.”<sup>89</sup></p> <p><i>DOT Common Rule</i> – “When real property is no longer needed for the originally authorized purpose, the grantee or subgrantee will request disposition instructions from the awarding agency. The instructions will provide for one of the following alternatives: . . . (2) Sale of property. Sell the property and compensate the awarding agency. The amount due to the awarding agency will be calculated by applying the awarding agency’s percentage of participation in the cost of the original purchase to</p>
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<sup>87</sup> 14 C.F.R. § 155.7(b). See also FAA Order 5190.6B, § 22.17(e) (Application of Proceeds from the Sale of Surplus Real Property).

<sup>88</sup> 49 U.S.C. § 47107(c)(2). See also FAA Order 5190.6B, § 22.18 (Release of Federal Obligations in Regard to Real Property Acquired with Federal Grant Assistance).

<sup>89</sup> 49 U.S.C. § 47107(c)(2)(A).



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	<p>the proceeds of the sale after deduction of any actual and reasonable selling and fixing-up expenses.”<sup>90</sup></p>
<p><b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b></p>	<p>“The Secretary may grant an exemption to a sponsor from the provisions of sections 47107 and 47152 of this title (and any other law, regulation, or grant assurance) to the extent necessary to waive any obligation of the sponsor to repay to the Federal Government any grants, or to return to the Federal Government any property, received by the airport under this title, the Airport and Airway Improvement Act of 1982, and any other law.”<sup>91</sup></p>
<p><b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b></p>	<p>“It is not necessary for the public sponsor to return to the FAA the unamortized value of grant-funded projects or surplus or non-surplus property received from the federal government, as long as the grant-funded facilities and donated property continue to be used for the original airport purposes. To assure this continued use, the private operator should be required to agree specifically to continue the airport uses of grant-funded facilities and federally donated property for the purposes described in FAA grant agreements and property deeds.”<sup>92</sup></p>

<sup>90</sup> 49 C.F.R. § 18.31(c).

<sup>91</sup> 49 U.S.C. § 47134(b)(2).

<sup>92</sup> FAA Order 5190.6B, § 6.15(c)(3).

<b>IS A PUBLIC AIRPORT OWNER PERMITTED TO USE SALE OR LEASE PROCEEDS TO REPAY THE GENERAL FUND FOR PRIOR CONTRIBUTIONS TO THE AIRPORT?</b>	
<b>GENERAL LEGAL STANDARD</b>	<p>“[A]ny request by a sponsor or any other governmental entity to any airport for additional payments for services conducted off of the airport or for reimbursement for capital contributions or operating expenses shall be filed not later than 6 years after the date on which the expense is incurred; and any amount of airport funds that are used to make a payment or reimbursement as described in subparagraph (A) after the date specified in that subparagraph shall be considered to be an illegal diversion of airport revenues that is subject to subsection (n) [Recovery of Illegally Diverted Funds].”<sup>93</sup></p> <p>“A sponsor may use its airport revenue to repay funds contributed to the airport from general accounts or to repay loans from the general account to the airport provided the sponsor makes its request for reimbursement within six (6) years of the date on which it made the contribution.”<sup>94</sup></p>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	Public owner may seek an exemption from the prohibition on revenue diversion in accordance with 49 U.S.C. § 47134(b)(1) (quoted above). General rule would apply where the public airport owner did <i>not</i> request or receive an exemption from the prohibition on revenue diversion.
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	General rule applies. Reimbursement subject to six-year statute of limitations.

<sup>93</sup> 49 U.S.C. § 47107(f)(5).

<sup>94</sup> FAA Order 5190.6B, § 15.9(c). *See also Policy and Procedures Concerning the Use of Airport Revenue*, § V(A)(4).

**WHAT RESTRICTIONS APPLY TO PRIVATE OPERATOR’S USE OF REVENUE GENERATED FROM AIRPORT?**

<p><b>GENERAL LEGAL STANDARD</b></p>	<p>“The rules of airport revenue apply to a public or private airport that has received federal financial assistance (as defined in paragraph 15.8 of this chapter) and the federal obligations for use of airport revenue incurred as a result of that assistance were in effect on or after October 1, 1996.”<sup>95</sup></p>
<p><b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b></p>	<p>“The Secretary may grant an exemption to a purchaser or lessee from the provisions of sections 47107(b) and 47133 of this title (and any other law, regulation, or grant assurance) to the extent necessary to permit the purchaser or lessee to earn compensation from the operations of the airport.”<sup>96</sup></p>
<p><b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b></p>	<p>“The transfer will not be approved unless the private operator agrees to assume all of the existing obligations of the public sponsor under the grant agreements and surplus and nonsurplus property deeds. For future grants, the private operator will agree to the assurances applicable to a private operator, but initially will also be obligated to comply with the public operator’s assurances as long as they would have remained in effect for the public operator.”<sup>97</sup></p>

<sup>95</sup> FAA Order 5190.6B, § 15.7(a)(3).

<sup>96</sup> 49 U.S.C. § 47134(b)(3).

<sup>97</sup> FAA Order 5190.6B, § 6.15(c)(1).

**WHAT RESTRICTIONS APPLY TO PRIVATE OPERATOR’S IMPOSITION OF RATES AND CHARGES?**

<p><b>GENERAL LEGAL STANDARD</b></p>	<p>“[A] State or political subdivision of a State may levy or collect - . . . (2) reasonable rental charges, landing fees, and other service charges from aircraft operators for using airport facilities of an airport owned or operated by that State or subdivision.”<sup>98</sup></p> <p>“The Secretary of Transportation may approve a project grant application under this subchapter for an airport development project only if the Secretary receives written assurances, satisfactory to the Secretary, that –</p> <p>(2) air carriers making similar use of the airport will be subject to substantially comparable charges –</p> <p>(A) for facilities directly and substantially related to providing air transportation”<sup>99</sup></p>
<p><b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b></p>	<p>“[T]he sponsor shall not be prohibited from -- . . . collecting reasonable rental charges, landing fees, and other service charges from aircraft operators under section 40116(e)(2) of this title.”<sup>100</sup></p> <p>“The Secretary may approve an application under subsection (b) only if the Secretary finds that the sale or lease agreement includes provisions satisfactory to the Secretary to ensure the following:</p> <p>. . .</p> <p>(4) Every fee of the airport imposed on an air carrier on the day before the date of the lease of the airport will not increase faster than the rate of inflation unless a higher amount is approved – (A) by at least 65 percent of the air carrier serving the airport; and (B) by air carriers whose aircraft landing at the airport during the preceding calendar year had a total landed weight during the preceding calendar year of at least 65 percent of the total landed weight of all aircraft landing at the airport during such year.</p> <p>(5) The percentage increase in fees imposed on general aviation aircraft at the airport not exceed the percentage increase in fees imposed on air carriers at the airport.”<sup>101</sup></p> <p>“In evaluating the reasonableness of a fee imposed by an airport receiving an</p>

<sup>98</sup> 49 U.S.C. § 40116(e).

<sup>99</sup> 49 U.S.C. § 47107(a)(2). *See also*, DOT/FAA, *Policy Regarding Airport Rates and Charges*, 61 Fed. Reg. 31994 (1996) *vacated in part by Air Transport Ass’n v. DOT*, 119 F.3d 38, *amended by* 129 F.3d 625 (D.C. Cir. 1997).

<sup>100</sup> 49 U.S.C. § 47134(g).

<sup>101</sup> 49 U.S.C. § 47134(c).

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	exemption under section 47134 of this title, the Secretary shall consider whether the airport has complied with section 47134(c)(4).” <sup>102</sup>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>Private operator would <i>not</i> be subject to Anti-Head Tax Act, but would be subject to Grant Assurances, for at least the duration of the last agreement binding on the public owner and perhaps longer if private operator sought and received grants from the discretionary fund.</p> <p>In the 1996 Policy Regarding Airport Rates and Charges, DOT provided that “a private equity owner of an airport can include a reasonable return on investment in the airfield”, but conditioned this authority by stating, “A private equity owner of an airport who has included a reasonable rate of return element in the rate base may not include an imputed interest charge as well.”<sup>103</sup> However, these portions of the Policy were vacated by the U.S. Court of Appeals.<sup>104</sup></p>

<sup>102</sup> 49 U.S.C. § 47129(a)(4).

<sup>103</sup> *Policy Regarding Airport Rates and Charges*, §§ 2.4 and 2.4.1(a).

<sup>104</sup> *Air Transport Ass’n of Am. v. DOT*, 119 F.3d 38, amended by 129 F.3d 625 (D.C. Cir. 1997).

<b>IS A PRIVATE OPERATOR ELIGIBLE FOR APPORTIONMENT FROM AIP ENTITLEMENT FUND?</b>	
<b>GENERAL LEGAL STANDARD</b>	Private operators are <i>not</i> eligible for apportionment of entitlement funds pursuant to 49 U.S.C. § 47114.
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	“Notwithstanding that sponsor of an airport receiving an exemption under subsection (b) is not a public agency, the sponsor shall not be prohibited from . . . (2) receiving apportionments under section 47114 of this title . . .” <sup>105</sup>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	“The private operator will be subject to the general AIP criteria for grants to private operators, and will not be subject to or benefit from the special provisions of the airport privatization pilot program. Accordingly, the private operator should be advised that it will not be eligible for apportionment of entitlement funds under 49 U.S.C. § 47114(c) . . .” <sup>106</sup>

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<sup>105</sup> 49 U.S.C. § 47134(g).

<sup>106</sup> FAA Order 5190.6B, § 6.15(c)(5).

<b>IS A PRIVATE OPERATOR ELIGIBLE FOR GRANTS FROM AIP DISCRETIONARY FUND?</b>	
<b>GENERAL LEGAL STANDARD</b>	<p>“The [discretionary] fund is available for making grants for any purpose for which amounts are made available under section 48103 of this title that the Secretary considers most appropriate to carry out this subchapter.”<sup>107</sup></p> <p>“[Private Airport Owner] may be an individual, a partnership, corporation, etc., that owns a public-use airport used or intended to be used for public purposes that is a reliever airport or an airport that has at least 2,500 passenger boardings each year and receives scheduled passenger aircraft service.</p> <p>A privately owned airport sponsor, as defined in a. above, is eligible for funding for: (1) Airport development projects; (2) Airport master planning; (3) Noise compatibility planning; and (4) Noise program implementation projects.”<sup>108</sup></p> <p>Federal share of project cost will be 75% or 90% depending on the NPIAS status of the airport.<sup>109</sup></p>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	<p>“The United States Government’s share of allowable projects costs is – . . . (4) 70 percent for a project funded by the Administrator from the discretionary fund under section 47115 at an airport receiving an exemption under section 47134 . . .”<sup>110</sup></p>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>General rule applies. Private operator meeting FAA’s definition may apply for grants from discretionary fund for eligible projects.</p>

<sup>107</sup> 49 U.S.C. § 47115(b).

<sup>108</sup> FAA Order 5100.38C, *Airport Improvement Program Handbook*, § 208 (2005).

<sup>109</sup> See 49 U.S.C. § 47109(a).

<sup>110</sup> 49 U.S.C. § 47109(a).

<b>IS A PRIVATE OPERATOR AUTHORIZED TO IMPOSE A PASSENGER FACILITY CHARGE?</b>	
<b>GENERAL LEGAL STANDARD</b>	<p>No authority to impose PFC.</p> <p>49 U.S.C. § 40117(b) provides that the Secretary may authorize an “eligible agency” to impose a passenger facility fee. Section 40117(a)(2) defines an “eligible agency” to mean “a public agency that controls a commercial service airport.”</p>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	<p>“Notwithstanding that the sponsor of an airport receiving an exemption under subsection (b) is not a public agency, the sponsor shall not be prohibited from – (1) imposing a passenger facility fee under section 40117 of this title . . .”<sup>111</sup></p>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>“[T]he private operator should be advised that it will not be eligible . . . for imposition of a passenger facility charge at the airport.”<sup>112</sup></p>

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<sup>111</sup> 49 U.S.C. § 47134(g).

<sup>112</sup> FAA Order 5190.6B, § 6.15(c)(4).



**IS A PRIVATE OPERATOR REQUIRED TO SEPARATELY OBTAIN AN AIRPORT OPERATING CERTIFICATE?**

<p><b>GENERAL LEGAL STANDARD</b></p>	<p>“The Administrator of the Federal Aviation Administration shall issue an airport operating certificate to a person desiring to operate an airport – (1) that serves an air carrier operating aircraft designed for at least 31 passenger seats; (2) that is not located in the State of Alaska and serves any scheduled passenger operation of an air carrier operating designed for more than 9 passenger seats but less than 31 passenger seats; and (3) that the Administrator requires to have a certificate; if the Administrator finds, after investigation, that the person properly and adequately is equipped and able to operate safely under this part and regulations and standards prescribed under this part.”</p>
<p><b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b></p>	<p>“FAA operating certificates are not transferable; a new operator of a certified airport must obtain a new certificate issued by the FAA.”<sup>113</sup></p>
<p><b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b></p>	<p>“As with any change of airport owner/operator, FAA certificates do not transfer. If the airport is certificated under 14 CFR Part 139, that certification will not transfer to the private operator and would need to be reissued.”<sup>114</sup></p>

<sup>113</sup> FAA, *Notice of Final Application Procedures*, 62 Fed. Reg. 48693, 48694 (1997).

<sup>114</sup> FAA Order 5190.6B, § 6.15(c)(5).

<b>IS A PRIVATE OPERATOR REQUIRED TO MAINTAIN AN AIRPORT SECURITY PROGRAM?</b>	
<b>GENERAL LEGAL STANDARD</b>	<p>“No person may operate an airport subject to Sec. 1542.103 unless it adopts and carries out a security program that – (1) Provides for the safety and security of persons and property on an aircraft operating in air transportation or intrastate air transportation against an act of criminal violence, aircraft piracy, and the introduction of an unauthorized weapon, explosive, or incendiary onto an aircraft; (2) Is in writing and is signed by the airport operator; (3) Includes the applicable items listed in Sec. 1542.103; (4) Includes an index organized in the same subject area sequence as Sec. 1542.103; and (5) Has been approved by TSA.”<sup>115</sup></p> <p>Section 1542.103 imposes distinct requirements for “complete”, “supporting” and “partial” security programs, based on the nature of operations by air carriers and foreign air carriers.</p>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	<p>49 U.S.C. § 47134 does not specifically address security requirements. Section 47134(c)(6) provides that, as a condition of approval, the Secretary must be satisfied that “[s]afety and security at the airport will be maintained at the highest possible levels.”</p>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>“[I]f the airport has a security plan in effect in accordance with Transportation Security Administration (TSA) regulations, TSA should be advised of the request for approval of the transfer of airport management responsibility. TSA will advise the airport sponsor if additional amendments are necessary.”<sup>116</sup></p>

<sup>115</sup> 49 U.S.C. § 1542.101(a).

<sup>116</sup> FAA Order 5190.6B, § 6.15(c)(5).

**IS THE PUBLIC OWNER OR PRIVATE OPERATOR OBLIGATED TO PROVIDE LAW ENFORCEMENT AT AIRPORT UPON TRANSFER?**

<p><b>GENERAL LEGAL STANDARD</b></p>	<p>“[E]ach airport operator required to have a [complete or supporting security program] must provide: (1) law enforcement personnel in the number and manner adequate to support its security program.</p> <p>Each airport required to have a [partial security program] must ensure that: (1) Law enforcement personnel are available and committed to response to an incident in support of a civil aviation security program when requested by an aircraft operator or foreign air carrier that has a security program under part 1544 or 1546 of this chapter.”<sup>117</sup></p>
<p><b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b></p>	<p>49 U.S.C. § 47134 does not specifically address security requirements. Section 47134(c)(6) provides that, as a condition of approval, the Secretary must be satisfied that “[s]afety and security at the airport will be maintained at the highest possible levels.”</p>
<p><b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b></p>	<p>“[I]f the airport has a security plan in effect in accordance with Transportation Security Administration (TSA) regulations, TSA should be advised of the request for approval of the transfer of airport management responsibility. TSA will advise the airport sponsor if additional amendments are necessary.”<sup>118</sup></p>

<sup>117</sup> 49 C.F.R. § 1542.215.

<sup>118</sup> FAA Order 5190.6B, § 6.15(c)(5).

## ***Appendix F***

### ***U.S. Regulatory and Policy Framework***

#### **F.1 Objective of Appendix**

The purpose of this appendix is to describe the legal structure of U.S. airports and the effects of this structure on airport privatization, to describe the legal standards and procedures for privatizing an airport under the Airport Privatization Pilot Program, 49 U.S.C. § 47134 (“APPP”) and the standards and procedures for other forms of full and partial privatization, and to identify the lessons learned from prior and current efforts to privatize airports within the U.S. legal structure.

Appendix F.1 provides a list of acronyms for this chapter.

#### **F.2 Introduction**

The legal framework for operating public-use airports in the United States is unique and has significantly influenced the experience and evolution of airport privatization in this country. The U.S. legal structure provides abundant opportunities for airport owners and operators to enlist private participation in certain airport functions and facilities while retaining primary responsibility and control over the airport, referred to herein as “partial privatization”. At the same time, this legal structure significantly circumscribes opportunities to transfer the ownership and/or primary control of public-use airports to a private operator, referred to herein as “full privatization.”

In particular, airport operators agree to abide by extensive conditions in consideration for the receipt of federal grants under the Airport Improvement Program (AIP). This financing structure historically dis-incentivized full privatization as a result of (1) the availability of federal funding for public entities to build and develop airports; (2) the constraints imposed by the grant conditions, known as “sponsor assurances” or “grant assurances,” and (3) the prospect that public entities would be required to repay prior grants upon the sale or lease of an airport to a private operator. While Congress lowered certain barriers to full privatization through the APPP, it erected new conditions on privatization and left other limits in place.

#### **F.3 Legal Constraints on Airport Privatization**

Privatization implicates a wide range of legal principles affecting airport operations. The following subsections describe the primary features of the legal structure and those features that have directly influenced airport privatization.

##### **F.3.1 Basic Legal Structure of Airports**

Although private enterprise initially played a role in building and operating commercial service airports, today virtually all commercial service airports, and most public-use general aviation airports, are owned and controlled by a state, regional, or municipal entity. These state and local governments are imbued with powers under state law necessary to operate, maintain and develop airports, such as the power to acquire and lease property, issue debt, enter into contracts, sue and be sued, etc.

Beginning with the Civil Aeronautics Act of 1938 and the Federal Airport Act of 1946, the federal government imposed a series of overlapping controls and requirements on public-use airports. The most extensive and demanding requirements are the grant assurances. There are 39 grant assurances, controlling *both* the manner in which the airport owner must carry out grant-funded projects and the manner in which the airport owner must operate the airport. The grant assurances control such diverse topics as the treatment of aeronautical users, rate-setting, reporting, planning, encroachment, civil rights, and land acquisition.

Several grant assurances are particularly relevant here, including the following:

1. *Assurance 5* prohibits the airport owner from taking action that would deprive it of the rights and powers necessary to comply with the other grant assurances, and prohibits the transfer of airport property without FAA approval.
2. *Assurance 20* requires the airport owner to take appropriate action to mitigate airport hazards and prevent future hazards.
3. *Assurance 21* requires the airport owner to take appropriate action to promote compatible land uses around the airport.
4. *Assurance 22* requires the airport owner to make the airport available for public use on reasonable terms and without unjust discrimination.
5. *Assurance 23* prohibits an airport owner from granting an exclusive right to conduct an aeronautical activity at the airport.
6. *Assurance 24* requires the airport owner to impose rates and charges in such a manner and at such levels as to make the airport as self-sustaining as possible under the circumstances.
7. *Assurance 25* requires the airport owner to use airport revenue only for the capital and operating costs of the airport, the local airport system, or other local facilities owned or operated by the airport owner and which are directly and substantially related to the air transportation of passengers or property.

Beyond the grant assurances, there are several additional direct and indirect federal controls on airports that are relevant to the discussion of privatization, particularly including the following:

- *Airport Operating Certificates* – Unlike pilots, air carriers and aircraft, each of which is required to be licensed or certificated, only airports that accommodate certain types of aeronautical activities are required to be certified by the FAA. Specifically, federal law requires that airports with scheduled air carrier operations in aircraft with more than 9 seats and/or unscheduled air carrier operations in aircraft with more than 30 seats must obtain and comply with an Airport Operating Certificate.<sup>1</sup> Airports without the triggering level of commercial passenger service, and General Aviation airports with no commercial passenger service, are not required to maintain an Airport Operating Certificate, but are subject to the grant assurances. The statute's implementing regulations, found at 14 C.F.R. Part 139, require each certificate holder to take certain actions and satisfy certain standards concerning, for example, runway safety areas, airfield marking and lighting, wildlife

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<sup>1</sup> 49 U.S.C. § 44706.

hazards, and aircraft rescue and firefighting. The requirement to obtain and abide by the conditions of an Airport Operating Certificate applies equally to public and private operators.

- *Surplus Property Act Deed Restrictions* – The Surplus Property Act of 1944 and subsequent statutes authorized the federal government to convey airports that it owned and operated to public entities for civil use at no cost.<sup>2</sup> The transfer was conditioned on, among other things, the public entity making the airport available for public use on reasonable conditions and without unjust discrimination and without granting exclusive rights to conduct aeronautical activities. The federal government can retake title to the property in the event of default.
- *Prohibition on Revenue Diversion* – Federal law, in addition to the grant assurances, prohibits the use of airport revenue for purposes other than airport capital and operating costs.<sup>3</sup> This rule was designed to ensure that the federal investment in airports would not be undermined by redirecting revenue derived from airports to other government functions. As described throughout and in the referenced source material, this prohibition on “revenue diversion” historically was the principal constraint on full privatization because it meant, among other things, that the public entity that owned the airport could not use the proceeds from the sale or lease for non-airport purposes.
- *Prohibition on Granting Exclusive Rights* – Federal law, in addition to the grant assurances, prohibits the grant of an exclusive right to conduct aeronautical activities at airports that have ever received federal financial assistance.<sup>4</sup> Unlike the grant assurances, which may have a limited duration, this proscription lasts in perpetuity. This prohibition applies only to aeronautical activities. It does not prohibit monopolies in, for example, car rentals, parking, and concessions. Moreover, airport management itself is not an aeronautical activity.
- *Controls on Rate-setting* – The Anti-Head Tax Act (“AHTA”) imposes a requirement, independent of the grant assurances, that public entities operating airports must impose only “reasonable” charges for aeronautical use of the airport.<sup>5</sup> Congress later required the U.S. Department of Transportation (USDOT) to issue guidance on how it would evaluate fee disputes.<sup>6</sup> USDOT issued its policy on rates and charges in 1996, and amended the

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<sup>2</sup> Current authority is found at 49 U.S.C. § 47151.

<sup>3</sup> 49 U.S.C. § 47133(a) (“Local taxes on aviation fuel (except taxes in effect on December 30, 1987) or the revenues generated by an airport that is the subject of Federal assistance may not be expended for any purpose other than the capital or operating costs of – (1) the airport; (2) the local airport system; or (3) any other local facility that is owned or operated by the person or entity that owns or operates the airport that is directly and substantially related to the air transportation of passengers or property.”).

<sup>4</sup> 49 U.S.C. § 40103(e) (“A person does not have an exclusive right to use an air navigation facility on which Government money has been expended.”)

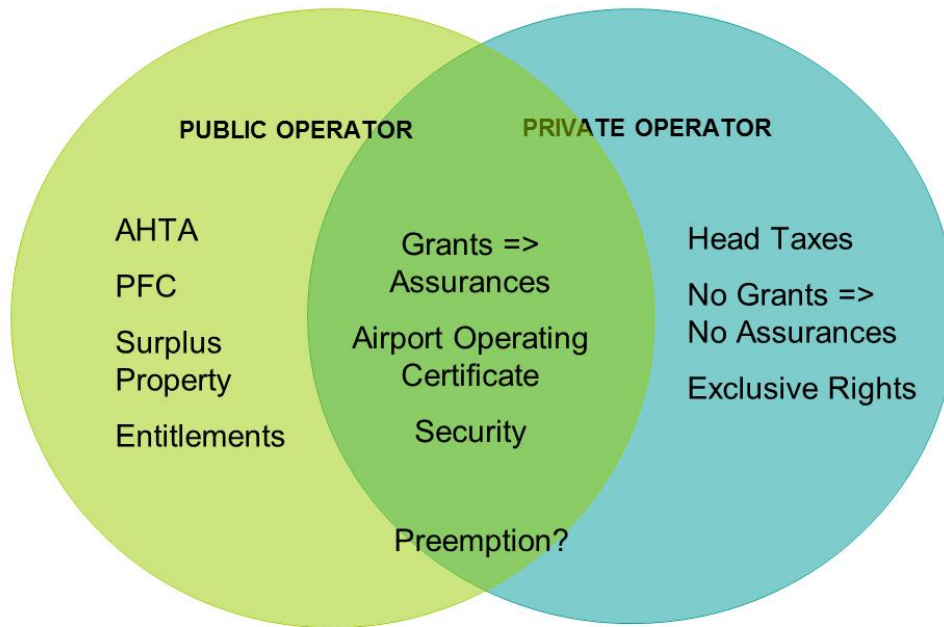
<sup>5</sup> 49 U.S.C. § 40116(e) (“Except as provided in subsection (d) of this section, a State or political subdivision of a State may levy or collect - . . . (2) reasonable rental charges, landing fees, and other service charges from aircraft operators for using airport facilities of an airport owned or operated by that State or subdivision.”).

<sup>6</sup> 49 U.S.C. § 47129.

policy in 2008.<sup>7</sup> Like the statutory prohibition on exclusive rights, the AHTA applies only to aeronautical users of an airport. The rates imposed upon non-aeronautical users are subject to less demanding standards under the U.S. Constitution.

Figure F.1 is a summary of the legal constraints applying to public and private operators and shows the overlap between the two business models.

**Figure F.1. Legal Constraints on Public and Private Operators**



### F.3.2 Effects of Legal Structure on Privatization

These direct and indirect federal controls dramatically affect the incentives and opportunities for privatizing public-use airports. The following requirements have influenced whether public airport operators have pursued partial or full privatization, and more specifically, have created opportunities for an airport owner to enlist private participation while remaining the airport sponsor (partial privatization) and simultaneously erected barriers to transferring sponsorship to a private operator (full privatization):

<sup>7</sup> Under the policy, airports may recover only “historic” costs for airfield assets and public use roadways, but for non-airfield facilities, the policy permitted fees to be set by any “reasonable” method. The U.S. Court of Appeals vacated provisions of policy regarding the rules distinguishing between airfield and non-airfield fees and remanded the matter to USDOT. *Air Transport Ass’n of America v. DOT*, 119 F.3d 38 (D.C. Cir. 1997) amended by 129 F.3d 625 (D.C. Cir.). USDOT has not amended the policy to address this issue and instead has adjudicated disputes over non-airfield rates and charges on a case-by-case basis. In 1999, the U.S. Court of Appeals confirmed USDOT’s determination that historic cost, and not “opportunity cost”, is the appropriate method of setting rates for airfield assets, in the context of a dispute over rates and charges at Los Angeles International Airport. *City of Los Angeles v. DOT*, 165 F.3d 972 (D.C. Cir. 1999). In 2009, the U.S. Court of Appeals remanded a subsequent dispute over rates and charges at LAX to USDOT to justify its disparate treatment of airfield and non-airfield assets. *Alaska Airlines v. DOT*, 575 F.3d 750 (D.C. Cir. 2009).

- *FAA approval authority* – Assurance 5 requires FAA approval before the airport owner can “sell, lease, encumber or otherwise transfer or dispose of any part of its title or other interests” in the airport. The Surplus Property Act and subsequent statutes authorizing transfer of federal property for public airports contain similar requirements. In practice, FAA approval is required only for a sale or long-term lease of airport property to a public or private entity. Public airport owners can enter into management contracts, concession agreements, leases of airport facilities and a host of other agreements with private entities without FAA approval. USDOT and FAA thus act as the gate-keeper to full privatization. Historically, full privatization efforts effectively were halted when FAA interjected itself into the process to explain the applicable federal conditions and requirements.
- *Revenue use* – Both federal law and the grant assurances strictly limit the use of airport revenue for non-airport purposes. “Airport revenue” is defined broadly to include the proceeds from the sale or lease of airport property. There are some narrow exceptions, such as for so-called “grandfathered” airports and for repayment of loans issued by sponsoring governments. However, Congress has expressed serious concern with revenue diversion and has prescribed onerous penalties for violations. The prohibition on revenue diversion applies only to the airport owner, not the air carriers, fixed base operators (FBOs), concessions, private airport managers, or any other private entities that conduct business on an airport. This has incentivized private ventures on airports but disincentivized full privatization. It presents a particularly high barrier to full privatization because the public airport owner is required to use the sale proceeds for airport purposes, and because the private operator, upon assuming responsibility for the grant assurances, must use revenue that it generates in connection with the airport for airport purposes.
- *Grant eligibility* – Under the Airport Improvement Program, public entities are eligible to receive an apportionment from the Entitlement Fund and to receive grants from the Discretionary Fund. In contrast, private entities are not eligible to receive an apportionment, and only private operators of certain types of airports are eligible for certain types of discretionary grants. Specifically, public-use airports operated by a private entity that are designated as relievers or that have at least 2,500 annual passenger boardings are eligible for funding for airport development projects, airport master planning, noise compatibility planning and noise program implementation projects. As explained more fully in Task 6, this financing structure historically dis-incentivized full privatization because it encouraged public entities to retain the role of sponsor, and thus eligibility for funding under the AIP.
- *Grant repayment* – As described in greater detail below, another historical barrier to full privatization was the uncertainty as to whether a public airport owner would be required to repay the federal government upon sale or long-term lease to a private operator, for the value of land acquired from the federal government under the Surplus Property Act, for the value of land acquired with federal financial assistance, or for the value of grant-funded capital improvements. The relevant statutes clearly require reinvestment or repayment in the event the property is sold for a non-airport use; however, the statutes are ambiguous as to whether the reinvestment or repayment obligation is triggered by transfer of the airport to a private operator for continued use as a public airport. This uncertainty historically disincentivized full privatization because of the potential financial liability associated with



privatization. However, Congress and the FAA effectively resolved this uncertainty by declaring that repayment typically would not be required to fully privatize an airport.

- *Control over non-aeronautical activities* – Based on the legal authorities noted above, airport owners have considerably greater control over non-aeronautical activities than aeronautical activities. For example, airport owners must charge a minimum of fair market value for non-aeronautical use, but have considerable flexibility, subject to Constitutional standards, to charge higher amounts for rent and other fees. Similarly, airport owners are not subject to the prohibition on granting exclusive rights with respect to non-aeronautical users of an airport. While public airport operators theoretically are subject to suit under the anti-trust statutes, many courts have found that public entities are immune from liability for certain anti-competitive behavior. Private entities would not enjoy similar immunity. Overall, this legal structure supports *both* full and partial privatization. As to full privatization, the greater control and flexibility over non-aeronautical activities presents the opportunity for a private operator to generate a return on its investment by maximizing non-aeronautical revenues to the greatest extent permitted by the market. As to partial privatization, airport operators can enlist private participation in non-aeronautical activities through, for example, master concession agreements and similar vehicles, to give private enterprise a significant role in non-aeronautical activities.
  
- *Constitutional Rights and Protections* – State and local governments acting as airport operators must not deprive airport tenants and users of the rights and protections afforded by the U.S. Constitution. These rights and protections include, for example, freedom of speech and the press under the First and Fourteenth Amendments, and equal protection and due process rights under the Fifth and Fourteenth Amendments. While private parties typically are *not* responsible for guaranteeing Constitutional rights and protections, courts have applied the Constitution to private actors providing a “public function”<sup>8</sup> or where the private action is “entwined” or “entangled”<sup>9</sup> with state action. One court has held that a private entity operating an airport pursuant to a lease with the public airport owner is subject to the Constitution.<sup>10</sup> However, the extent to which private airport operators engaged in the range of activities described herein as full and partial privatization would be deemed state actors responsible for guaranteeing Constitutional rights and protections is uncertain.

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<sup>8</sup> *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 115 S.Ct. 961, 130 L.Ed.2d 902 (1995); *West v. Atkins*, 487 U.S. 42 (1988) (private physician employed part-time by a state prison hospital); *Lugar v. Edmondson Oil Co.*, 457 U.S. 922 (1982) (private seizure of property executed under a state garnishment statute); *Terry v. Adams*, 345 U.S. 461 (1953) (privately-run public elections); *Marsh v. Alabama*, 326 U.S. 501 (1946) (conduct on public streets in a company town); *but see Blum v. Yaretsky*, 457 U.S. 991 (1982) (private nursing home receiving government funds), *Rendell-Baker v. Kohn*, 457 U.S. 830 (1982) (private, remedial high school receiving government funds); *Moose Lodge No. 107 v. Irvis*, 407 U.S. 163 (1972) (private club with a state-issued liquor license).

<sup>9</sup> *Brentwood Acad. v. Tenn. Secondary Schools Athletic Ass'n*, 531 U.S. 288 (2001) (private athletic association 84% of whose members are public schools); *Evans v. Newton*, 382 U.S. 296 (1966) (public park created by private will, but maintained and supervised by a municipality); *Pennsylvania v. Bd. of Dirs. of City Trusts of Philadelphia*, 353 U.S. 230 (1957) (private school operated by a state agency); *but see Nat'l Collegiate Athletic Ass'n v. Tarkanian*, 488 U.S. 179 (1988) (national athletic association with members from many states not a “state actor” with respect to Nevada law).

<sup>10</sup> *Niswonger v. Am. Aviation, Inc.*, 424 F. Supp 1080 (D. Tenn. 1976).

- *Property Taxes* – Public airport operators enjoy exemptions from property taxation pursuant to the constitution and/or laws of most states. This exemption typically is limited to a public entity operating an airport and therefore would not apply to a private operator of a public-use airport. This tax structure dis-incentivizes full privatization, at least any transfer that would jeopardize the airport’s eligibility for an exemption.

## **F.4 Events Leading to the Airport Privatization Pilot Program**

When the APPP became law as part of the 1996 FAA Reauthorization Act, it was the result of a decade-long effort by the FAA and the U.S. Department of Transportation (USDOT) to resolve several outstanding issues with leasing or selling publicly funded and regulated U.S. airports. The APPP was a compromise between privatization advocates and those skeptical about, or downright hostile, to it. The new pilot program, by resolving several legal uncertainties, created the conditions for a limited version of airport privatization.

### **F.4.1 Early Efforts at Privatization**

While the requirement that airport owners agree to abide by certain conditions in exchange for federal assistance has been in place since the Federal Airport Aid Act of 1946, the current policy regime was established by the Airport and Airway Improvement Act of 1982 (AAIA).<sup>11</sup> Beginning with the AAIA and through subsequent amendments, Congress set forth the principle captured in Assurance 25 that *any* airport revenue, including revenue received through commercial activities of the airport unrelated to air transportation, be used for the capital and operating costs of the airport, the local airport system, or other facilities owned or operated by the airport owner. The logic was clear: Congress was only going to provide airports with grant money if they were assured that airport monies that otherwise could be available for capital development, were not transferred to an illegitimate use, such as balancing local or state budgets. Forbidding “revenue diversion” was viewed as protecting taxpayers, aviation passengers and airlines and, in fact, the integrity of AIP itself. The prohibition on revenue diversion was then—and is today—supported by the airport community as the principal protection against local politicians using aviation money, much of it collected from those outside their jurisdictions, to subsidize other services.

Because any proceeds from a lease or sale are deemed to be airport revenue, however, this prohibits an airport owner from taking the sale or lease proceeds and using it for a non-airport purpose. Indeed, cashing out the value of an airport by sale or lease to use the revenue for a non-airport purpose arguably is the most extreme form of the problem that Congress, USDOT and FAA set out to stop. As the proceeds are one of the most important benefits an owner would potentially receive from privatizing an airport, its unconditional application would strongly discourage privatizations.

Occurring just after the AAIA was passed and when FAA was just beginning to put in rules to implement the statute, privatization posed some regulatory challenges. In 1986 (after the AAIA’s prohibition on revenue diversion but prior to the FAA’s issuance of a formal policy statement), the FAA approved the lease of the Atlantic City International Airport’s passenger terminal to Johnson Controls World Services, a private firm, for an annual minimum payment of \$400,000. The money was not reinvested in the airport, but was diverted to the city’s general fund for non-

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<sup>11</sup> Public Law 97-248.

airport purposes. During this time, the FAA continued to provide grants to the airport. Six years later, the City sold the airport for \$11.5 million and annual payments of \$500,000, which were deposited in the City's general fund.<sup>12</sup> The GAO notes that the 1992 deal was specifically sanctioned in a 1992 law passed by Congress.<sup>13</sup>

Following the Atlantic City lease, beginning in 1989, leaders of Albany County (New York) explored several options for leasing Albany County Airport.<sup>14</sup> They did so for three stated reasons. First, a desire to reduce the risk to local taxpayers, who had previously subsidized the airport out of the County's general fund, especially during the 1970s and 1980s. Second, leaders hoped to procure resources from one of the region's top assets, given that Albany County was then experiencing an economic downturn and its airport was by then running an operating surplus. And third, an effort to determine whether or not some of the proceeds from privatization could be used to upgrade the airport, widely perceived by the local community to be a substandard facility for New York's capital city.

The county assessed several options, including a sale and lease with a local public regional transportation authority and to private firms. After working with the FAA and legal counsel, the county presented an option to the FAA that, in turn, sought guidance from the U.S. Department of Justice (DOJ). FAA officials sought guidance, in part, because of the complexities of the matter and because they had given a variety of opinions on several iterations of Albany County's proposals over the 1989 to 1991 period. It took a legal opinion to clarify several outstanding legal matters.<sup>15</sup>

The county proposal was for a 40-year lease, with an option for an additional 40 years. The deal was to be between the county and a private, joint venture of British American Ltd. and Lockheed Air Terminal (BALLAT). BALLAT offered the county \$30 million as an initial payment for a 170-acre parcel adjacent to the airport, which it would then sell back to the county for \$1. The county would divert the \$30 million for general expenses to obligations unrelated to the airport. The county would also receive annual payments of \$500,000 for the first 20 years of the lease, and \$1 million for the next 20 years, depositing the lease payments in an interest-bearing fund dedicated to airport development. BALLAT would recoup its \$30 million from airport revenues, including landing fees.

Both the FAA and the county accepted that the \$30 million constituted airport revenue and both also agreed that the county could reasonably recoup some of the subsidies ("unreimbursed capital and operating expenses") from airport revenue, which the county had paid to the airport over the years. The county tallied these at \$26.3 million.<sup>16</sup> The FAA believed that the recovery should be

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<sup>12</sup> U.S. Government Accounting Office, *Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports*, GAO/RCED 97-3 at 36 and 37 (November 1996)

<sup>13</sup> Public Law 102-143. § 335.

<sup>14</sup> For a good description see Kennedy School of Government Case Program, President and Fellows of Harvard College, *Privatizing the Albany County Airport: Abridged* C16-91-1024.3 (1991).

<sup>15</sup> Office of Legal Counsel, U.S. Department of Justice Legal Opinion, *Re: Application of the Airport and Airway Improvement Act to the Proposed Lease of Albany County Airport* (Feb. 12, 1991). Included in U.S. Senate, Subcommittee on Aviation, Committee on Commerce, Science and Transportation, 104<sup>th</sup> Congress, 2<sup>nd</sup> session. *Hearing on Airport Revenue Diversion* (S. Hrg. 104-629) at 155-167 (May 1, 1996).

<sup>16</sup> *Id.* at 158.

proximate or spelled out at the time when the subsidies were provided; otherwise it was revenue diversion. DOJ, however, could find no statutory basis for a time limitation on recouping the subsidies and sided with the county's position that it did not constitute diversion. However, on one other critical matter, DOJ sided with FAA. The opinion found, consistent with today's grant assurance 22, that the "FAA may oversee the rates charged to airport users by BALLAT—including the extent to which they may permissibly reflect BALLAT's \$30 million payment to Albany County."<sup>17</sup> The themes of the Atlantic City and Albany cases – revenue diversion, recouping past investments, concern for users, and regulation of rate setting – would be critical elements that would have to be resolved in future privatizations of AIP-supported airports and would become cornerstones of the APPP.<sup>18</sup>

In the late 1980s and early 1990s, the issues of revenue diversion and rate-setting were growing concerns. Two different USDOT Inspector Generals alleged dozens of cases of airport owners illegally diverting airport revenue, including the over-estimation of unreimbursed capital and operating expenses.<sup>19</sup> At the same time, there were a growing number of disputes on the fees assessed by airports on the airlines and other users of their facilities. Ultimately this would lead to Congress in the FAA Reauthorization Act of 1994 requiring USDOT to issue "final regulations, policy statements, or guidelines" governing airport fees and the settling of airport-airline disputes.<sup>20</sup> While possible privatizations were not the primary focus of these disputes, a comprehensive approach to privatization demanded that USDOT and FAA *first* resolve what public airport owners could charge airlines and other users and *then* consider whether the same or different rules apply to private operators.

#### F.4.2 Federal Efforts at Privatizing Infrastructure

Even as the FAA and USDOT were attempting to resolve uncertainties for Albany County Airport and for airport regulation generally, both the Bush and Clinton administrations were asking their executive agencies to explore how they could encourage state and local governments to experiment with the concept of privatization and the greater use of private-sector financing.

- *Executive Order 12803* – On April 30, 1992, President George H.W. Bush signed Executive Order 12803, which was intended to reduce the barriers to privatization based on the principle that "State and local governments should have greater freedom to privatize infrastructure assets."<sup>21</sup> The Order specifically required the heads of executive departments and agencies to "[r]eview those procedures affecting the management and disposition of federally financed infrastructure assets owned by State and local governments and modify those procedures to encourage appropriate privatization of such assets consistent with this order."<sup>22</sup>

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<sup>17</sup> *Id.* at 167.

<sup>18</sup> The Federal Aviation Administration Reauthorization Act of 1996 addressed this issue by setting a six-year statute of limitations on unreimbursed expenses. See 49 U.S.C. § 47107(l)(5).

<sup>19</sup> See, for example, Airport Cooperative Research Program, *Legal Research Digest 2: Theory and Law on Revenue Diversion* at 26 and 27 (May, 2008).

<sup>20</sup> Public Law 103-305. In 1996, USDOT announced its Policy Regarding Airport Rates and Charges, 61 Fed. Reg. 31, 1994 (June 21, 1996). It remains a subject of airport-airline disputes today.

<sup>21</sup> Exec. Order 12803, § 2(a) (April 30, 1992).

<sup>22</sup> *Id.* § 3(a).

- *Executive Order 12893* – On January 26, 1994, President William J. Clinton signed Executive Order 12893 that, while not focused directly on the subject of privatization, stated, “Agencies shall seek private sector participation in infrastructure investment and management.”<sup>23</sup>

In 1995 as the 104<sup>th</sup> Congress convened, privatization would get a jump-start aided by sympathetic Republicans in the House of Representatives. Republicans had won control of the House for the first time in 40 years and many in the majority party believed in reducing the size and scope of the federal government, including its role supporting state and local infrastructure. For example, in June 1995, Representative McIntosh of Indiana sponsored H.R. 1907, the Federal-aid Facility Privatization Act of 1995. Like Executive Order 12803, the bill was intended to require executive departments and agencies to “[a]ssist State and local governments in their efforts to privatize their infrastructure assets.”<sup>24</sup> The bill specifically addressed the issues of grant repayment and revenue use.<sup>25</sup> The bill, and a companion bill in the U.S. Senate, did not reach the floor for a vote.

In contrast, in the early to mid-1990s, for the U.S. airport industry and the vast majority of airport owners and CEOs, selling or leasing an airport was something that was occurring in the rest of the world and did not have particular relevance to them. In the U.S., public airports had federal airport capital grants funds available (AIP), new authorization to collect passenger facility charges (PFCs) from passengers, and access to tax-exempt debt, which reduced the borrowing rates available to them in the capital markets by as much as 200 to 250 basis points (2.00% to 2.50%). In addition, many had long-term use and lease agreements with the airlines that would have to be renegotiated if they sought to change the rate-setting methodology.

PFCs, in particular, recently passed as part of the Aviation Safety and Capacity Act of 1990, provided airports with the ability to charge passengers up to \$3.00 per departure (with a maximum of two PFCs for a one-way passenger itinerary).<sup>26</sup> While PFCs required airport consultation with airlines and federal approval, they were exempted from the terms of airport-airline use and lease agreements and thus provided a new source of capital independent of the airlines. For the vast majority of airport operators, the new PFC was far more relevant than was privatizing their airports, and by providing public airport owners with a new source of available capital, actually became a reason for airports not to privatize.

U.S. airport CEOs also valued the fact that they were public. First, unlike some of their non-U.S. counterparts, they were not responsible to a larger corporation and shareholders and did not have to meet annual expectations of delivering profitable returns. Airports do have to be as “self-sustaining” as possible under grant assurance 24, but for many airports with use and lease agreements that allow them to recover their costs, this is not normally a high hurdle, and a requirement to be self-sustaining is certainly a lower expectation than those faced by a private airport. Second, because they do not have to make a profit, U.S. airports can think of providing service as their bottom-line—air service, providing access to their community, and service to the passengers and other users who pass through their facilities. Third, self-interested airport CEOs

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<sup>23</sup> Exec. Order 12893, § 2(c) (Jan. 26, 1994).

<sup>24</sup> H.R. 1907, § 3(a).

<sup>25</sup> *Id.* §§ 5 and 6.

<sup>26</sup> Public Law 101-508. The PFC program today is contained in 49 U.S.C. § 40117.

recognize that they are chosen according to public criteria by public boards. Fourth, the movement to privatize infrastructure in the U.S., while garnering more attention, was still in its infancy. Fifth and finally, to the extent that communities considered transferring primary responsibility for the airport to another entity, the first choice typically was another public entity, particularly airport authorities or intergovernmental authorities, which explicitly had been provided for in many state statutes. For many, therefore, privatization was simply not salient to their daily experience.

### **F.4.3 Congressional Debate Leading to Section 47134**

In February and March 1996, the House Subcommittee on Aviation held a series of hearings in preparation for FAA Reauthorization. On February 29, 1996, the Subcommittee held a hearing exclusively dedicated to the issue of airport privatization.

The introductory comments from members of the Subcommittee did not suggest strong support or enthusiasm for airport privatization. No statements were made on the record about the ideological benefits of smaller government and the need for greater participation by private enterprise. Rather, each member indicated that the primary benefit of privatization would be to provide an alternative funding source for airport development, made necessary by the inability of traditional sources to support needed capital development. (This hypothesis is examined more fully in Task 6.)

The Subcommittee heard testimony from the U.S. General Accounting Office; the Air Transport Association; the Airport Group International; BAA USA; Rothschild, Inc.; and the Port Authority of New York and New Jersey. The ATA representative stated the airlines opposition to airport privatization generally, and to Representative McIntosh's H.R. 1907 in particular. The remaining speakers described, in somewhat generalized terms, the benefits to be gained by airport privatization.

The U.S. General Accounting Office submitted testimony focusing particular attention on the prohibition on revenue diversion and the potential need to repay past grants as the principal legal barriers to airport privatization.<sup>27</sup> Referring to the Albany case and the DOJ opinion in particular, GAO also identified the lack of clear rules and guidelines from FAA as a further impediment to privatization.

In the subsequent months, the House of Representatives developed and adopted a pilot program as part of H.R. 3539, its version of FAA Reauthorization:

- *Participation:* USDOT could approve up to six airports in the program, at least one of which had to be a non-commercial service airport;
- *Revenue Diversion:* With the approval of 60% of the air carriers serving the airport and the approval of air carriers representing 60% of the total landed weight at the airport, the Secretary could exempt participating airports from the prohibition on using airport revenue for non airport purposes. Thus, the sponsoring authority could use the proceeds

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<sup>27</sup> U.S. General Accounting Office, *Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports* (Statement of Gerald Dillingham), GAO/T-RCED-96-82 (Feb. 29, 1995).

from the sale for any purpose. The exemption could be revoked if a privatized airport violated the terms of the program.

- *Repayment of Federal Grants and Donated Federal Land:* H.R. 3539 allowed the Secretary to waive the requirement that a privatized airport would have to repay federal grants or the value of federal land that had been made part of the airport.
- *Rate-Setting:* Two requirements circumscribed airport rate-setting. First, the same 60% of air carriers would have to approve any fee assessed on air carriers that was above the rate of inflation. Second, the airport had to be made available on “reasonable” terms, meaning the FAA and USDOT retained their regulation of the rates charged by privatized airports.
- *Access to Capital:* participating airports could continue to have access to AIP entitlements and could assess PFCs on air carriers.<sup>28</sup>

The House version met many of the goals of the various parties. For privatization advocates, the concept of privatization would get a trial, lasting as long as the period of the authorization. For the FAA, airports under the privatization pilot program would remain regulated and its interests in protecting access to the facilities on reasonable terms were retained. For air carriers, they could be assured that their approval would be required, giving them significant leverage over the terms of any lease and, even once approved, their approval would be required for any fee increases above the rate of inflation and they would continue to have protection against any unreasonable fees assessed by the airport.

Representative Tom DeLay (R-Texas), the House Majority Whip, spoke favorably of the pilot program: “Cities and counties should have the discretion to consider airport privatization as a means to fund needed capital improvements and promote economic development. It is clear that federal airport development resources will be limited. And, many cities need to create new capacity at their existing airports to meet surging demand for air services, creating pressure on cities and counties to consider alternative sources of capital.”<sup>29</sup>

In contrast, for Representative Peter DeFazio (D-Oregon), waiving the obligation to repay federal grants was “just another example of corporate welfare. The Federal grants amount to a windfall for private investors, at the expense of the U.S. taxpayers.”<sup>30</sup>

The Senate did not address privatization in its version of FAA Reauthorization as many of its leaders, including Commerce Committee Chair John McCain (R-Arizona) and William Ford (D-Kentucky), were unenthusiastic. In addressing the issue on the Senate floor, Senator Ford returned to the issue of revenue diversion: “The conferees were very concerned about the ability to divert revenues under a privatization scheme. However, Los Angeles was the real concern. As a result, we limited the number and type of airports eligible for the pilot program.”<sup>31</sup> House-Senate conferees would ultimately limit the number of airports to five, and designate that only one of the five would be a large hub airport (like Los Angeles International Airport).

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<sup>28</sup> 104<sup>th</sup> Congress, H.R. 3539, FAA Authorization Act of 1996.

<sup>29</sup> Cong. Rec. E1629 (Sept. 17, 1996).

<sup>30</sup> Cong. Rec. H10140 (Sept. 10, 1996).

<sup>31</sup> Cong. Rec. S12232 (Oct. 3, 1996).

The Committee of Conference ultimately arrived at a version of the pilot program that contained many of the features in the House bill, but with some greater controls. The Conference Report provides as follows:

The Managers have agreed to a limited pilot program to determine if new investment and capital from the private sector can be attracted through innovative financial arrangements. The managers spent a great deal of time discussing and debating a series of conditions and limitations. The managers are aware that Allegheny County Airport, a general aviation facility in Pennsylvania, and Stewart Airport in New York State are interested in pursuing these innovative arrangements. The managers anticipate that all airport applications should be appropriately considered and that the Secretary should select airports for this pilot program based on the best qualified candidates.<sup>32</sup>

In addition to limiting the pilot program to five, rather than six, airports, the legislation required USDOT to provide a report to the relevant House and Senate committees within two years on the implementation of the program.<sup>33</sup> While this may have been intended or viewed as a means of limiting the pilot program to two years, the legislation did not provide a sunset or end date for the program.

Subsequent floor statements confirmed mixed Congressional support for the pilot program, albeit with greater support in the House than Senate. For example, the Chairman of the House Aviation Subcommittee, Representative John Duncan (R-Tennessee), spoke favorably about the pilot program: “With scarce Federal dollars we need to be looking at new ways of doing things. And I think this pilot program will be very successful just as other privatization efforts have been in several other countries. It will be good for the taxpayers and the flying public.”<sup>34</sup> Representative Bud Shuster (R-Pennsylvania) observed, “This is a pilot program, but I am confident that the success of the program will convince the skeptics that privatization of some airports can be extremely beneficial.”<sup>35</sup>

However, Senator Ernest Hollings (D-South Carolina) took a different twist to Representative DeFazio’s corporate welfare argument, “The provision continues to trouble me. Under the legislation, an airport can be privatized and still receive a Federal grant. If the private sector believes it can suddenly revitalize airports with claims of new money, why does the Federal Government have to provide corporate welfare?”<sup>36</sup>

The General Accounting Office (GAO) supplemented its testimony from the February hearing in a report filed in November 1996, after Congress had enacted the APPP.<sup>37</sup> In it, the GAO examined the issue of private participation in airports generally, not solely focusing on the sale or lease of airports. The report is often cited for its finding that based on a survey of 69 of the nation’s

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<sup>32</sup> H.R. Conf. Report No. 104-848, at 91 (1996).

<sup>33</sup> 49 U.S.C. § 47134(f).

<sup>34</sup> Cong. Rec. H11457 (Sept. 27, 1996).

<sup>35</sup> Cong. Rec. E1868 (Sept. 30, 1996).

<sup>36</sup> Cong. Rec. S12233 (Oct. 3, 1996).

<sup>37</sup> U.S. General Accounting Office, *Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports*, GAO/RCED-97-3 (Nov. 1996).



largest airports, 90% of the employees at airports work for private entities, such as airlines, rental car companies, and concessionaires.<sup>38</sup>

The GAO report considered the role of private enterprise in airport management and identified ten specific instances in which an airport owner had considered selling or leasing the airport or a significant airport facility such as a terminal.<sup>39</sup>

Although released after Congress enacted the APPP, the GAO report made the following findings regarding the legal barriers to airport privatization: (1) the prohibition on revenue diversion is “the major obstacle,” (2) the potential requirement to repay past grants or return airport property to the federal government may present an obstacle, (3) noise, environmental and land-use requirements are not significant barriers, (4) safety and security requirements are not significant barriers, and (5) bond covenants may restrict privatization.<sup>40</sup>

## **F.5 Airport Privatization Pilot Program**

The APPP, as enacted in 1996 and amended in 2003, reduced uncertainty about the privatization process and addressed the recognized barriers to privatization by permitting USDOT to grant exemptions from certain federal obligations that historically stymied full privatization. However, Congress required that airports and private operators satisfy demanding conditions in exchange for the exemptions and approvals, including conditions specifically designed to protect its interests and those of the airport users. The FAA thereafter prescribed detailed procedures for seeking these exemptions and approvals. Viewed as a whole, the APPP today is complex, demanding, and lengthy. This is in part because full privatization transactions are more complicated in general, but also due to the specific legislative requirements imposed by the APPP.

### **F.5.1 49 USC 47134**

The federal law creating the APPP prescribes the following requirements:

1. A general aviation airport may be sold or leased. A commercial service airport may be leased only.<sup>41</sup>
2. Only five airports may receive approval to privatize under the APPP.<sup>42</sup> One of the five airports must be a general aviation airport.<sup>43</sup> No more than one airport may be a large hub primary airport.<sup>44</sup>
3. The Secretary may permit the public airport owner to use sale or lease proceeds for non-airport purposes upon approval (i) in the case of a primary airport, by at least 65% of the scheduled air carriers and by scheduled and unscheduled air carriers accounting for 65% of aircraft landed weight at the airport, and (ii) in the case of a nonprimary airport, by

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<sup>38</sup> *Id.* at 26-27.

<sup>39</sup> *Id.* at Tbl. 3.1.

<sup>40</sup> *Id.* at 36 - 41.

<sup>41</sup> 49 U.S.C. § 47134(a).

<sup>42</sup> *Id.* § 47134(b).

<sup>43</sup> *Id.* § 47134(d)(1).

<sup>44</sup> *Id.* § 47134(d)(2).

the Secretary after the airport has consulted with at least 65% of the owners of aircraft based at the airport.<sup>45</sup>

4. The Secretary may exempt the public airport owner from any legal requirement to repay prior grants or return airport property to the federal government.<sup>46</sup>
5. The Secretary may permit the private operator to use airport revenue for non-airport purposes in order to “earn compensation from the operations of the airport.”<sup>47</sup>
6. The statute requires that the following nine conditions must be satisfied to obtain approval:
  - a. The airport will continue to be available for public use on reasonable terms and without unjust discrimination.
  - b. The airport will continue to operate in the event the private operator becomes insolvent, seeks bankruptcy protection, or under similar circumstances.
  - c. The private operator will maintain, improve and modernize the airport in accordance with plans submitted to the Secretary.
  - d. Rates and charges on air carriers will not increase faster than the rate of inflation unless a faster increase is approved by at least 65% of the air carriers serving the airport and by air carriers accounting for at least 65% of aircraft landed weight at the airport.
  - e. The fees on general aviation aircraft will not increase faster than the rate of increase for air carriers.
  - f. Safety and security at the airport will be maintained at the highest possible levels.
  - g. Noise effects will be mitigated to the same extent as at a public airport.
  - h. Adverse environmental effects will be mitigated to the same extent as at a public airport.
  - i. The sale or lease will not abrogate any collective bargaining agreement covering airport employees.<sup>48</sup>
7. The Secretary must conclude expressly that approving the sale or lease will not result in unfair and deceptive practices or unfair methods of competition.<sup>49</sup>
8. The Secretary must ensure that the interests of general aviation users at the airport are not adversely affected by the sale or lease.<sup>50</sup>
9. The private operator will be eligible to impose a Passenger Facility Charge.<sup>51</sup>
10. The airport will be eligible to receive an apportionment from the Entitlement Fund.<sup>52</sup>

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<sup>45</sup> *Id.* § 47134(b)(1)(A).

<sup>46</sup> *Id.* § 47134(b)(2).

<sup>47</sup> *Id.* § 47134(b)(3).

<sup>48</sup> *Id.* § 47134(c).

<sup>49</sup> *Id.* § 47134(e).

<sup>50</sup> *Id.* § 47134(f).

<sup>51</sup> *Id.* § 47134(g)(1).

11. The private operator may impose “reasonable rental charges, landing fees, and other service charges from aircraft operators” consistent with the Anti-Head Tax Act.<sup>53</sup>
12. The federal share of financial assistance in grants issued from the Discretionary Fund issued to a private operator is 70% of project costs.<sup>54</sup>

### **F.5.2 FAA Application Procedures**

In September 1997, the FAA published detailed procedures for the submission and review of applications to sell or lease an airport in accordance with Section 47134.<sup>55</sup> The application procedures have the following key features:

1. There is a two-step application process, beginning with a preliminary application, which, if accepted for review, will secure an airport’s position as one of the five airports in the APPP. The public airport operator can file a final application once it has selected a private operator. (Note that the public airport operator can submit a final application without first submitting a preliminary application.)
2. The FAA will notify the airport within 30 days whether it has accepted a preliminary application, and thereafter publish notice in the Federal Register that the FAA has accepted the application for review.
3. A preliminary application must include, among other things, a summary of the public airport owner’s objectives in privatizing the airport and a description and timetable for selecting a private operator, including the request for proposals.
4. The final application is far more detailed and must identify and describe the parties to the transaction, the airport property to be transferred, the terms of the transfer, the qualifications of the private operator, the requests for exemption, a certification of air carrier approval, and plans for the future operation and development of the airport.
5. To enable USDOT to determine whether certain statutory conditions will be satisfied, USDOT requires information in the final application necessary to conduct a fitness test on the private operator (e.g., experience, financial resources, etc.).
6. USDOT will solicit public comment on a final application.
7. USDOT’s approval or rejection of an application and specific exemptions is contained in a Record of Decision.

*Foreign Investment* – In addition to the FAA application procedures, it is possible that the sale or lease of an airport to a private operator that is a foreign entity may be subject to investigation by the Committee on Foreign Investment in the United States (“CFIUS”).<sup>56</sup> An

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<sup>52</sup> *Id.* § 47134(g)(2).

<sup>53</sup> *Id.* § 47134(g)(3).

<sup>54</sup> *Id.* § 47109(a). In the initial version of the APPP adopted in 1996, the federal share was 40%. It was increased to 70% by *Vision 100 - Century of Aviation Reauthorization Act of 2003*, Pub. Law No. 108-176, § 163 (2003).

<sup>55</sup> FAA, *Notice of Final Application Procedures, Airport Privatization Pilot Program: Application Procedures*, 62 Fed. Reg. 48693 (1997).

<sup>56</sup> See 50 U.S.C. § 2170. See also Dept. of Treasury, Final Rule, *Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons*, 73 Fed. Reg. 70716 (2008); Dept. of Treasury, Notice, *Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States*, 73 Fed. Reg. 74567 (2008).

investigation may be initiated by the President, by the CFIUS, or based on voluntary notice of the intended transaction to the CFIUS. The President can prohibit the transfer upon finding that the foreign interest threatens to impair national security. Alternatively, the CFIUS can impose conditions to mitigate an identified threat. The CFIUS is concerned principally with transactions by which a U.S. business would become controlled directly or indirectly by a foreign government.

### **F.5.3 FAA Decisions Under the APPP**

As detailed elsewhere in this Guidebook, only one airport has received approval from FAA to privatize under the APPP: Stewart International Airport in Newburgh, New York. FAA approved the State of New York's final application in February 2000. FAA's findings, statements, and determinations in the Record of Decision provide important guidance on the agency's interpretation of Section 47134 and, equally important, present an image of the legal structure of an airport that has privatized under the APPP.

The following is a summary of the key elements of the agreement and key FAA determinations in approving New York State's application:

1. The State of New York Department of Transportation ("NYSDOT") leased the airport to SWF Airport Acquisition, Inc. ("SWFAA"), a wholly-owned subsidiary of National Express Corporation, for a period of 99 years. The lease included an industrial park but excluded an Air National Guard Base and an area that was the subject of environmental remediation.
2. SWFAA agreed to pay \$35 million, in a series of initial payments, to lease the airport, and rent payments reflecting 5% of gross income beginning after Year 10 or once total passenger traffic reached 1,380,000.
3. NYSDOT did not obtain the requisite approval by air carriers operating at the airport necessary to exempt NYSDOT from the prohibition on revenue diversion. However, the State was able to document that it had made loans to the airport within the preceding 6 years totaling nearly \$25 million. The FAA required that the remainder of the initial lease payment and future percentage rent payments must be used exclusively for airport purposes.
4. FAA, with limited discussion, waived any requirement that NYSDOT repay prior grants or return property conveyed by the federal government, seemingly on the basis that the property would continue to be used as an airport.
5. FAA granted an exemption to SWFAA from the prohibition on revenue diversion permitting SWFAA to reap a return on investment of between 3% and 35%. However, FAA conditioned its approval on SWFAA *first* meeting its obligations for investment in the airport before it could realize any return on investment.
6. FAA released NYSDOT from its status as airport sponsor and transferred responsibility for compliance with the grant assurances to SWFAA. However, FAA required NYSDOT to remain primarily responsible for certain grant assurances, particularly including Assurance 4 (Good Title), Assurance 20 (Hazard Removal and Mitigation), Assurance 21 (Compatible Land Use), Assurance 31 (Disposal of Land) and Assurance 35 (Relocation of Real

Property). NYSDOT further agreed to reassume primary responsibility for grant assurance compliance in the event SWFAA defaulted under the lease.

7. While a portion of the airport had been conveyed from the federal government pursuant to the successor statute to the Surplus Property Act, FAA determined that it was not necessary to grant an exemption from the Surplus Property Act. FAA did revise certain terms of the original deed so as to permit NYSDOT to lease the airport to a private operator. FAA did not declare explicitly whether it was relieving NYSDOT from its primary responsibility to ensure compliance with the deed restrictions.
8. NYSDOT and SWFAA agreed to confer third party beneficiary rights to FAA under the lease, enabling FAA to enforce the APPP conditions.
9. FAA concurrently issued an Airport Operating Certificate to SWFAA and approved SWFAA's proposed security plan (under the former security regulations overseen by FAA).

#### **F.5.4 Congressional Reconsideration of the APPP**

- *Congressional Hearing (1999)* - On June 30, 1999, the House Aviation Subcommittee held a hearing to consider the status of airport privatization. The Subcommittee received testimony from BAA USA, the Empire State Development Corporation, Diversified Asset Management Group, and the FAA. All parties recognized the limited level of privatization under the APPP; however, panelists testified as to the then-pending plans to privatize Stewart International Airport and San Diego Brown Field.
- *Amendments to APPP (2003)* - In *Vision 100 - Century of Aviation Reauthorization Act of 2003*, Congress made the following three changes to the APPP: (1) USDOT could exempt a non-primary airport from the prohibition on revenue diversion upon finding that the public airport operator consulted with a minimum of 65% of the owners of based aircraft; (2) air carriers have only 60 days to approve or object to a requested exemption from the prohibition on revenue diversion; and (3) the federal share for AIP discretionary grants was increased to 70%.
- *Report to Congress (2004)* - In August 2004, FAA submitted a report to Congress as required by Section 47134. FAA found that "it is too early to conclude whether privatization of airports in the United States under the pilot program can result in access to new sources of capital for airport development and improvements in customer service."<sup>57</sup> FAA did review the status of each application filed under the APPP and reported favorably on the privatization of Stewart International Airport, which received USDOT approval in 2000. FAA also identified common characteristics of the applicants, including: airport management was secondary or one of many responsibilities of the owner; the airports were underutilized and subsidized by the sponsoring government entity; the federal and local processes for pursuing privatization were long and time consuming; the private operators proposed to use a limited liability corporation to manage the airport; and success depended in part on strong political commitment.
- *Bush Administration (2007)* - In 2007, the Bush Administration proposed to amend the APPP through FAA Reauthorization. Although never acted upon, the proposal would

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<sup>57</sup> FAA, *Report to Congress on the Status of the Airport Privatization Pilot Program, United States Code, Title 49, Section 47134*, at 2 (2004).

have further reduced barriers to full privatization by, for example, increasing the number of airports eligible to participate in the APPP from 5 to 15, eliminating the requirement for air carrier approval to use sale or lease proceeds for non-airport purposes, eliminating certain conditions on USDOT approval, and eliminating the requirements as to the type of airports that are eligible to participate in the APPP.<sup>58</sup>

- *FAA Reauthorization (2011)* – In April 2011, the House and Senate passed their versions of FAA Reauthorization. The House bill (H.R. 658, FAA Air Transportation Modernization and Safety Improvement Act) would make significant changes to the APPP, while the Senate version would make no changes to current law. The House bill would:
  - Double the number of slots in the pilot program from five to ten and eliminate any set asides for use of any of the ten slots
  - Transform the 65% air carrier and general aviation user approval requirement for the revenue use exemption to a consultation requirement
  - Eliminate the protection for collective bargaining agreements
  - Strike the limitations on air carrier and general aviation fee increases
  - Add a provision that “a fee imposed by the airport on an air carrier or foreign air carrier may not include any portion for a return on investment or recovery of principal with respect to consideration paid to a public agency for the lease or sale of the airport unless that portion of the fee is approved by the air carrier or foreign air carrier”

Taken together, the House changes would significantly change the APPP and could lead to additional participation by airports. Given the bicameral disagreements, the competing House and Senate language would almost certainly be resolved in a conference committee between the two chambers. While the Senate appointed conferees in May 2011, the House has not appointed conferees as of December 2011.

## F.6 Privatization Outside the Pilot Program

Privatization can encompass a wide range of strategies, from privatizing particular airport functions such as the management of a terminal or even the entire airport operation, to privatizing the ownership of the airport with the long-term lease of a commercial service airport. The receipt of AIP and the explicit acceptance of grant assurances mean that an airport owner has effectively two alternatives to privatize: (1) retain sponsorship and privatize limited functions and/or facilities (partial privatization), and (2) transfer sponsorship, along with primary decision-making authority over the airport, to a private entity (full privatization). Full privatization itself has two sub-sets: (i) full privatization through the APPP or (ii) full privatization outside of the APPP. A private airport developer building on a green-field site without federal assistance is not privatizing *per se* and represents a distinct type of airport owner in the U.S.<sup>59</sup>

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<sup>58</sup> *Next Generation Air Transportation System Financing Reform Act of 2007*, § 806.

<sup>59</sup> The four are (1) public sponsors receiving AIP; (2) APPP airports; (3) privatized airports outside of the APPP; and (4) privately developed airports that have never received federal assistance.

### F.6.1 Rules for Sale or Lease Outside Pilot Program

Since 1996, no public airport operator has sought to sell or lease an airport to a private operator outside of the APPP. However, this option remains available, and may be pursued in the event that either all the available slots in the APPP program are encumbered, or if an owner chooses to do so without the regulatory boundaries of the APPP. FAA has not published guidance specifically on this subject; however, FAA provided some guidelines in the *Airport Compliance Manual*, released in September 2009.<sup>60</sup>

Privatizing outside the APPP has the following attributes:

1. FAA approval is required.
2. FAA will review a request to transfer an airport to a private operator in a similar fashion to its review of a request to transfer an airport to another public entity.
3. FAA may require the public airport operator to maintain concurrent responsibility for certain grant assurances, such as the obligations concerning compatible land use and hazards to air navigation.
4. FAA will not approve an application without a commitment by the private operator to assume responsibility for the grant assurances and any Surplus Property Act deed restrictions.
5. FAA will not exempt the public airport operator from the prohibition on revenue diversion, but may permit the private operator to recover its initial investment and receive compensation for managing the airport.
6. FAA may not require repayment for the value of grant-funded projects and land transferred by the federal government.
7. The private operator will not be eligible for an apportionment from the Entitlement Fund.
8. The private operator will be required to obtain a separate Airport Operating Certificate and to prepare an Airport Security Program.

In a recent article, former FAA official David Bennett argues that public owners of airports would be better off privatizing outside of the APPP if they are not seeking to divert revenue, defined as using the proceeds from a lease or sale for non-airport purposes. The potential benefits include removing the responsibility from operating an airport, having the airport developed by a private entity that may find new business opportunities that the public owner could not, and using the proceeds from a sale of the local airport to invest in other airports operated by the owner, something explicitly permitted by grant assurance 25.<sup>61</sup>

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<sup>60</sup> FAA Order 5190.6B, *Airport Compliance Manual*, § 6.15 (Privatization Outside of the Airport Privatization Pilot Program) (Sept. 2009).

<sup>61</sup> David L. Bennett, *Airport Privatization After Midway*, *The Air & Space Lawyer* v.23, (2010).

## **F.6.2 Rules for Management Contracts, Developer Financing Agreements, Service Contracts, etc.**

The FAA's *Airport Compliance Manual* contains important guidance on certain forms of partial privatization, particularly including management contracts.<sup>62</sup>

1. A public airport operator may contract with an agent to perform airport management or other administrative and supervisory functions. This arrangement may be defined in a management contract, lease or both.
2. The public airport operator remains the airport sponsor, and therefore is responsible for compliance with all grant assurances and other federal obligations. (Note that the difference between full and partial privatization in the instance of a lease of an entire airport is whether the public airport operator continues to be the airport sponsor.)
3. FAA strongly encourages public airport owners to execute separate agreements for airport management functions and aeronautical activities to be conducted by the private entity.
4. FAA recommends that a management agreement include particular terms requiring that the private entity to conduct its activities consistent with the grant assurances and other federal obligations imposed on the public airport operator and that the management agreement itself be subordinate to the grant assurances.

## **F.6.3 Rules for Private Airport Developer**

As indicated above, the direct and indirect federal controls on airports largely are the result of federal financial assistance to the airport. The legal structure applicable to an airport developed on a green-field site by a private entity without federal financial assistance is dramatically different. The private developer/operator would not be constrained by the grant assurances, statutory requirements applicable only to public entities (e.g., the AHTA), and statutory requirements applicable to entities that have received federal assistance at some point in the past (e.g., the statutory prohibition on revenue diversion found at 49 U.S.C. § 47133). Further, while it is possible that a private airport developer/operator would be deemed a "state actor" responsible for guaranteeing the rights and protections afforded by the U.S. Constitution (e.g., on the basis that operating a public-use airport is a public function), private airport developers/operators are the least likely to be deemed bound by the U.S. Constitution.

Freed from these constraints, a private developer/operator could, for example, do the following:

1. Impose user fees directly on passengers.<sup>63</sup>
2. Permit only certain air carriers to serve the airport.
3. Divert revenue from the airport.

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<sup>62</sup> FAA Order 5190.6B, § 6.13 (Airport Management Agreements).

<sup>63</sup> In considering the legality of an "airport facility charge" imposed by the private operator of the Branson Airport, DOT found that neither the AHTA nor the PFC statute applied, since the airport operator was not a public entity, but reserved judgment on whether the "reasonableness" requirement of 49 U.S.C. § 47129 applies to a private airport operator. Letter from S. Podberesky, DOT, to G. Wicks re: Branson Airport's Airport Facility Charge Request at (Jan. 16, 2009).



At the same time, a private developer/operator would not enjoy several of the protections afforded government entities. In particular, the private developer/operator would not be eligible for state constitutional and statutory exemptions from property taxation, and would not enjoy state action immunity from liability under the federal anti-trust statutes.

## **F.7 Lessons Learned**

With respect to full privatization, the APPP was created as a political compromise, negotiated among several public and private interests that sought an alternative to the traditional FAA model. It decidedly was *not* a decision to permit state and local governments to turn over airports entirely to private enterprise free from federal oversight. Airports are not only regulated under the APPP, as private airports are in other nations, but they retain eligibility for airport capital grants under AIP and they have to abide by many of the most important grant assurances imposed as part of their previous receipt of AIP funds. At least in the case of the long-term lease of a commercial service airport, the public entity remains concurrently responsible for certain grant assurances and other federal obligations. It may be argued that this is not privatization in its pure form but rather a half-measure by which the private operator takes on the role of airport owner in something akin to the traditional form, including both the financial support and regulatory burdens. Seen in this context, the APPP represents a “toe in the water” for privatization, one which remains heavily circumscribed within the regulatory structure of USDOT and the FAA and one affording protection to the airport’s most important tenants, the airlines and general aviation.

Viewing the APPP in this way also affects the relative merit of full privatization outside of the APPP, private airport development, and partial privatization. Privatizations under the APPP and outside the APPP both entail the transfer of sponsorship obligations to a private operator. The principal benefit of going through the lengthy application process under the APPP is the potential for an exemption from the prohibition on revenue diversion. Private airport development without federal assistance constitutes the only permissible means of operating an airport free of the grant assurances and other federal obligations.

Partial privatization remains the most common form of enlisting private participation in large part because it presents a far easier way for private entities to realize profits from their airport activities and because it reflects the serious challenges faced by any public airport owner that wishes to transfer or avoid its federal obligations.

Compared to other airport privatizations worldwide, the U.S. experience has been decidedly a modest one. That should not be surprising since the movement to privatize infrastructure is just over two decades old in the U.S. In addition, privatization is not yet a widely accepted solution for policymakers seeking to solve the problem of under-investment in infrastructure, especially airport infrastructure. Instead, policymakers have over the last two decades offered airport owners a wide range of benefits, including capital grants, a mechanism to charge passengers independent of airport-airline use and lease agreements, and federal tax subsidies. It is no wonder that U.S. airports have opted to take full advantage of these benefits.

Table F.1 presents a summary of the legal incentives and disincentives under partial and full privatization.

**Table F.1. Summary of Incentives/Disincentives to Partial and Full Privatization**

Issue	Partial Privatization	Full Privatization
FAA Approval	May or may not be needed, depending on structure and terms	Necessary and can deter
Revenue Use	Not a barrier	Requires express exemption
Grant Eligibility	Public entity remains sponsor and eligible	Entitlements only available through APPP; lower discretionary federal share for airports in APPP
Grant Repayment	n.a.	Not required if remains an airport
Control over Aeronautical Activities	Subject to grant assurances and AHTA standards	Under APPP, subject to caps, grant assurances, and AHTA reasonableness standard Outside APPP subject to grant assurances
Control over Non-aeronautical activities	Viable revenue source resulting from flexibility to control rates	Viable revenue source resulting from flexibility to control rates

In the next section, the last 15 years of the APPP and the FAA airports’ program are reviewed with an eye toward understanding the decision of whether or not an airport owner should opt to participate in the APPP. This choice is fundamental and unique to the U.S. experience.

## **F.8 Frequently Asked Legal Questions About Full Airport Privatization**

The following is a short summary - in the form of questions and answers - concerning the principal legal issues presented by full airport privatization within and outside of the APPP. The underlying source material (statutes, regulations, guidance, etc.) is provided in Appendix F.2.

### ***Question #1 – Is FAA approval required for sale or lease to a private operator?***

Yes. The sale or lease of an airport to a private operator, within or outside of the APPP, requires FAA approval.

### ***Question #2 – What conditions apply to FAA’s consideration of a request to sell or lease an airport to a private operator?***

Airports participating in the APPP must satisfy nine conditions prescribed by Section 47134. For privatization outside the APPP, the FAA requires that private operators agree to assume responsibility for the grant assurances, Surplus Property Act deed restrictions and other federal obligations. The FAA has not indicated what other conditions might apply to privatization outside of the APPP.

### ***Question #3 - Is the public airport owner or the private operator responsible for compliance with the grant assurances upon transfer?***

For privatization within or outside the APPP, the private operator will be responsible for compliance with the grant assurances, at least for so long as the grant assurances might otherwise remain applicable. Also, FAA may require that the public airport operator in either circumstance concurrently maintain responsibility for certain grant assurances.

### ***Question #4 – Will sale or lease proceeds constitute “airport revenue”?***

Yes. Sale or lease proceeds to any private owner will constitute airport revenue. However, an applicant under the APPP can request an exemption permitting the public airport owner to use sale or lease proceeds for non-airport purposes (see next question).

***Question #5 – What restrictions apply to a public airport owner’s use of sale or lease proceeds?***

Under the APPP, the Secretary may grant an exemption permitting the public airport owner to use sale or lease proceeds for non-airport purposes upon approval by 65% of air carriers, by number and landed weight, at a primary airport, and upon consultation with 65% of based aircraft at all other airports. If the applicant does not seek or obtain consent or conduct the required consultation, and for airports privatizing outside the APPP, the public airport owner is required to use sale or lease proceeds for airport purposes.

***Question #6 – Is a public airport owner required to reinvest or repay the federal government when selling or leasing property acquired with “federal assistance”?***

Section 47134 explicitly permits USDOT to excuse any reinvestment or repayment obligation. In 2009, the FAA clarified that public airport operators privatizing outside the APPP will not have to reinvest or repay prior grants so long as the airport continues to be made available for public use.

***Question #7 – Is a public airport owner permitted to use sale or lease proceeds to repay the General Fund for prior contributions to the airport?***

Yes. Whether or not privatizing under the APPP and whether or not a public airport operator receives approval by air carriers, the public airport operator can repay loans made by the sponsoring government within the preceding six years and repay loans pursuant to written obligations regardless of the date of the agreement.

***Question #8 – What restrictions apply to a private operator’s use of revenue generated from the airport?***

Section 47134 permits USDOT to grant an exemption from the prohibition on revenue diversion “to the extent necessary to permit the purchaser or lessee to earn compensation from the operations of the airport.” FAA guidance indicates that a private operator acting outside of the APPP would be subject to all of the grant assurances, presumably including the prohibition on revenue diversion. However, the FAA has acknowledged that a private operator may have a limited right to recover its initial investment and earn some measure of compensation for managing the airport.

***Question #9 – What restrictions apply to a private operator’s imposition of rates and charges?***

Section 47134 limits increases in fees imposed on air carriers to the rate of inflation unless higher increases are approved by 65% of air carriers (by number and landed weight), and limits the percentage increase in fees to General Aviation to the percentage increase charged to air carriers. While not subject to the AHTA’s requirement that rates and charges be “reasonable,” a private operator outside of the APPP would be subject to the reasonableness and unjust discrimination standards imposed by the grant assurances and may be subject to other requirements of the FAA Policy Regarding Airport Rates and Charges.

***Question #10 – Is a private operator eligible for apportionment from the AIP Entitlement Fund?***

Section 47134 explicitly authorizes a private operator to receive an apportionment from the Entitlement Fund. Private operators acting outside the APPP are not eligible for an apportionment.

***Question #11 – Is a private operator eligible for grants from the AIP Discretionary Fund?***

Section 47109 provides that the federal share for discretionary grants for airports privatized under the APPP shall be 70%. Private operators outside the APPP may be eligible for discretionary grants if the airport is a reliever airport or receives 2,500 annual passenger boardings.

***Question #12 – Is a private operator authorized to impose a Passenger Facility Charge?***

Section 47134 explicitly authorizes a private operator to impose a Passenger Facility Charge under the APPP. While private operators acting outside the APPP technically are not eligible to impose a Passenger Facility Charge, private operators may impose charges on enplaning passengers, because the Anti-Head Tax Act, to which the PFC statute is an exception, does not apply to private entities.

***Question #13 – Is a private operator required to separately obtain an Airport Operating Certificate?***

Yes. A private operator, within or outside the APPP, is required to request, secure, and maintain an Airport Operating Certificate pursuant to FAR Part 139 if the aeronautical activity at the airport demands a certificate.

***Question #14 – Is a private operator required to maintain an Airport Security Program?***

Yes. A private operator, within or outside the APPP, is required to maintain an Airport Security Program, depending on the nature and type of commercial passenger service.

***Question #15 – Is the public airport owner or the private operator obligated to provide law enforcement at the airport upon transfer?***

A private airport operator, within or outside the APPP, must provide law enforcement personnel or ensure that law enforcement personnel are available to respond to an incident, depending on the type of Airport Security Program in place at the airport.

## Appendix F.1

### Acronyms

<b>AAIA</b>	Airport and Airway Improvement Act of 1982
<b>AHTA</b>	Anti-Head Tax Act
<b>AIP</b>	Airport Improvement Program
<b>APPP</b>	Airport Privatization Pilot Program
<b>BALLAT</b>	British American Ltd. and Lockheed Air Terminal
<b>CFIUS</b>	Committee on Foreign Investment in the United States
<b>DOJ</b>	U.S. Department of Justice
<b>FAA</b>	Federal Aviation Administration
<b>GAO</b>	General Accounting Office, now the General Accountability Office
<b>NYSDOT</b>	State of New York Department of Transportation
<b>PFCs</b>	Passenger Facility Charges
<b>SWFAA</b>	SWF Airport Acquisition, Inc.
<b>USDOT</b>	U.S. Department of Transportation

## **Appendix F.2**

### **LEGAL ISSUES IN AIRPORT PRIVATIZATION: COMPILATION OF STATUTES, REGULATIONS AND GUIDANCE**

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**LEGAL ISSUES IN AIRPORT PRIVATIZATION:**

**COMPILATION OF STATUTES, REGULATIONS AND GUIDANCE**

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**LEGAL ISSUES IN AIRPORT PRIVATIZATION:  
COMPILATION OF STATUTES, REGULATIONS AND GUIDANCE**

<b>IS FAA APPROVAL REQUIRED FOR SALE OR LONG-TERM LEASE TO A PRIVATE OPERATOR?</b>	
<b>GENERAL LEGAL STANDARD</b>	<p><i>Grant-Obligated Airports</i> – “[The airport sponsor] will not sell, lease, encumber or otherwise transfer or dispose of any part of its title or other interests in the property shown on Exhibit “A” to this [grant] application or, for a noise compatibility program project, that portion of the property upon which federal funds have been expended, for the duration of the terms, conditions, and assurances in the grant agreement without approval by the Secretary.”<sup>64</sup></p> <p><i>Surplus Property Act Airports</i> – “A State, political subdivision of a State, or tax-supported organization receiving the interest may use, lease, salvage, or dispose of the interest for other than airport purposes only after the Secretary of Transportation gives written consent that the interest can be used, leased, salvaged, or disposed of without materially and adversely affecting the development, improvement, operation, or maintenance of the airport at which the property is located.”<sup>65</sup></p> <p>“Although surplus property instruments permit the conveyance to a third party, the sponsor must obtain FAA approval prior to its transfer, and the transferee must assume the federal obligations of the original grantee. In addition, a release deed will also be required.”<sup>66</sup></p>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	<p>“If a sponsor intends to sell or lease a general aviation airport or lease any other type of airport for a long term to a person (other than a public agency), the sponsor and purchaser or lessee may apply to the Secretary of Transportation for exemptions under this section.”<sup>67</sup></p>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>“Sale or lease of a public airport to a private airport operator is not prohibited by law, and the FAA may be requested to approve a transfer of ownership or operating responsibility of a public airport to a private operator without an application for participation in the airport privatization pilot program.”<sup>68</sup></p>

<sup>64</sup> Grant Assurance 5(b).

<sup>65</sup> 49 U.S.C. § 47152(1).

<sup>66</sup> FAA Order 5190.6B, *Airport Compliance Manual*, § 6.7(b) (2009).

<sup>67</sup> 49 U.S.C. § 47134(a).

<sup>68</sup> FAA Order 5190.6B, § 6.15(a).



**WHAT CONDITIONS APPLY TO FAA CONSIDERATION OF REQUEST TO SELL OR LEASE AN AIRPORT TO A PRIVATE OPERATOR?**

<p><b>GENERAL LEGAL STANDARD</b></p>	<p><i>Grant-Obligated Airports</i> – “Before a transfer to another entity can take place, the FAA must specifically determine the recipient is eligible and willing to perform all the conditions of the grant agreements. Otherwise, the FAA will not permit the transfer to occur.”<sup>69</sup></p> <p><i>Surplus Property Act Airports</i> – “A total release permitting the sale and disposal of real property acquired for airport purposes under the Surplus Property Act shall not be granted unless it can be clearly shown that the disposal of such property will benefit civil aviation.”<sup>70</sup></p>
<p><b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b></p>	<p>“The Secretary may approve an application under subsection (b) only if the Secretary finds that the sale or lease agreement includes provisions satisfactory to the Secretary to ensure the following:</p> <ol style="list-style-type: none"> <li>(1) The airport will continue to be available for public use on reasonable terms and conditions and without unjust discrimination.</li> <li>(2) The operation of the airport will not be interrupted in the event that the purchaser or lessee becomes insolvent or seeks or becomes subject to any State or Federal bankruptcy, reorganization, insolvency, liquidation, or dissolution proceeding or any petition or similar law seeking the dissolution or reorganization of the purchaser or lessee or the appointment of a receiver, trustee, custodian, or liquidator for the purchaser or lessee or a substantial part of the purchaser or lessee’s property, assets or business.</li> <li>(3) The purchaser or lessee will maintain, improve, and modernize the facilities of the airport through capital investments and will submit to the Secretary a plan for carrying out such maintenance, improvements, and modernization.</li> <li>(4) Every fee of the airport imposed on an air carrier on the date before the date of the lease of the airport will not increase faster than the rate of inflation unless a higher amount is approved – (A) by at least 65 percent of the air carriers serving the airport; and (B) by air carriers whose aircraft landing at the airport during the preceding calendar year had a total landed weight during the preceding calendar year of at least 65 percent of the total landed weight of all aircraft landing at the airport during such year.</li> <li>(5) The percentage increase in fees imposed on general aviation aircraft at the airport will not exceed the percentage increase in fees imposed on air carriers</li> </ol>

<sup>69</sup> FAA Order 5190.6B, § 6.7(a).

<sup>70</sup> FAA Order 5190.6B, § 22.17(a). *See also* 49 U.S.C. § 47153.

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	<p>at the airport.</p> <p>(6) Safety and security at the airport will be maintained at the highest possible levels.</p> <p>(7) The adverse effects of noise from operations at the airport will be mitigated to the same extent as at a public airport.</p> <p>(8) Any adverse effects on the environment from airport operations will be mitigated to the same extent as at a public airport.</p> <p>(9) Any collective bargaining agreement that covers employees of the airport and is in effect on the date of the sale or lease of the airport will not be abrogated by the sale or lease.”<sup>71</sup></p>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>“The transfer will not be approved unless the private operator agrees to assume all of the existing obligations of the public sponsor under grant agreements and surplus and nonsurplus property deeds.”<sup>72</sup></p>

<sup>71</sup> 49 U.S.C. § 47134(c).

<sup>72</sup> FAA Order 5190.6B, § 6.15(c)(1).

<b>IS THE PUBLIC AIRPORT OWNER OR THE PRIVATE OPERATOR RESPONSIBLE FOR COMPLIANCE WITH THE GRANT ASSURANCES UPON TRANSFER?</b>	
<b>GENERAL LEGAL STANDARD</b>	<p>“As a condition of release, the FAA will require the new operator to assume all existing grant obligations, and the FAA will review the transfer document to ensure there is no ambiguity regarding responsibility for the federal obligations.”<sup>73</sup></p> <p>“If the transferee is found by the Secretary to be eligible under Title 49, United States Code, to assume the obligations of the grant agreement and to have the power, authority, and financial resources to carry out all such obligations, the sponsor shall insert in the contract or document transferring or disposing of the sponsor’s interest, and make binding upon the transferee all of the terms, conditions, and assurance contained in this grant agreement.”<sup>74</sup></p> <p>“If an arrangement is made for management and operation of the airport by any agency or person other than the sponsor or an employee of the sponsor, the sponsor will reserve sufficient rights and authority to insure that the airport will be operated and maintained in accordance [with] Title 49, United States Code, the regulations and the terms, conditions and assurances in the grant agreement and shall insure that such arrangement also requires compliance therewith.”<sup>75</sup></p>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	<p>“The following statements and information must be included in the final application.</p> <p>...</p> <p>Part VII (Airport Operation and Development)</p> <p>...</p> <p>(B) The private operator’s acceptance of the grant assurances contained in the public sponsor’s grant agreements with the FAA.”<sup>76</sup></p> <p>“As a result of the transfer, the public sponsor should not be obligated for the airport grant assurances assumed by the private operator. However, the public sponsor may continue to have Federal obligations under the exemption approval. These Federal obligations may depend on: (1) The conditions of exemption; (2) third party beneficiary rights; and (3) specific terms of the transfer agreement.”<sup>77</sup></p>

<sup>73</sup> FAA Order 5190.6B, § 6.7(a).

<sup>74</sup> Grant Assurance 5(b).

<sup>75</sup> Grant Assurance 5(f).

<sup>76</sup> FAA, *Notice of Final Application Procedures*, 62 Fed. Reg. 48693, 48708 (1997).

<sup>77</sup> 62 Fed. Reg. at 48700.

	<p>“These leases and sales [under the APPP] also transfer the federal obligations to the private operator, although the FAA may require the public agency transferring the airport to retain concurrent responsibility for certain assurances if appropriate.”<sup>78</sup></p>
<p><b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b></p>	<p>“The transfer will not be approved unless the private operator agrees to assume all of the existing obligations of the public sponsor under grant agreements and surplus and nonsurplus property deeds. For future grants, the private operator will agree to the assurances applicable to a private operator, but initially will also be obligated to comply with the public operator’s assurances as long as they would have remained in effect for the public operator.”<sup>79</sup></p> <p>“As with transfers under the privatization pilot program, the FAA may require the public agency transferring the airport to retain concurrent responsibility for certain assurances if appropriate. For example, FAA may require a transferring public agency to maintain its ability to use its local zoning power to protect approaches to the airport.”<sup>80</sup></p> <p>Note: While there are some differences in the Grant Assurances applicable to public and private sponsors, several key Assurances apply equally to public and private sponsors, including without limitation: Assurance 19 (Operation and Maintenance), Assurance 22 (Economic Nondiscrimination), Assurance 23 (Exclusive Rights), Assurance 24 (Fee and Rental Structure) and Assurance 25 (Airport Revenues).</p>

<sup>78</sup> FAA Order 5190.6B, § 6.14(b).

<sup>79</sup> FAA Order 5190.6B, § 6.15(c)(1).

<sup>80</sup> FAA Order 5190.6B, § 16.15(b).

<b>WILL SALE OR LEASE PROCEEDS CONSTITUTE “AIRPORT REVENUE”?</b>	
<b>GENERAL LEGAL STANDARD</b>	<p>“All fees, charges, rents or other payments received by or accruing to the sponsor for any one of the following reasons are considered to be airport revenue: a. Revenue from air carriers, tenants, lessees, purchasers of airport properties, airport permittees making use of airport property and services, and other parties. Airport revenue includes all revenue received by the sponsor for the activities of others or the transfer of rights to others relating to the airport, including revenue received: . . . (ii) For the sale, transfer, or disposition of airport real property (as specified in the applicability section of this policy statement) not acquired with Federal assistance or personal airport property not acquired with Federal assistance, or any interest in that property, including transfer through a condemnation proceeding.”<sup>81</sup></p>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	<p>49 U.S.C. § 47134 does not re-characterize sale or lease proceeds as anything other than airport revenue. Instead, Section 47134(b) provides opportunity to seek and receive exemption from federal requirements on the use of airport revenue. (See below.)</p>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>General rule applies. Sale or lease proceeds are airport revenue.</p>

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<sup>81</sup> FAA, *Policy and Procedures Concerning the Use of Airport Revenue*, § II(B)(1), 64 Fed. Reg. 7696, 7716 (1999).

**WHAT RESTRICTIONS APPLY TO PUBLIC AIRPORT OWNER'S USE OF SALE OR LEASE PROCEEDS?**

<p><b>GENERAL LEGAL STANDARD</b></p>	<p>“The Secretary of Transportation may approve a project grant application under this subchapter for an airport development project only if the Secretary receives written assurances, satisfactory to the Secretary, that local taxes on aviation fuel (except taxes in effect on December 30, 1987) and the revenues generated by a public airport will be expended for the capital or operating costs – (A) the airport; (B) the local airport system; or (C) other local facilities owned or operated by the airport owner or operator and directly and substantially related to the air transportation of passengers or property.”<sup>82</sup></p> <p>“Local taxes on aviation fuel (except taxes in effect on December 30, 1987) or the revenues generated by an airport that is the subject of Federal assistance may not be expended for any purpose other than the capital or operating costs of – (1) the airport; (2) the local airport system; or (3) any other local facility that is owned or operated by the person or entity that owns or operates the airport that is directly and substantially related to the air transportation of passengers or property.”<sup>83</sup></p>
<p><b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b></p>	<p>“The Secretary may grant an exemption to a sponsor from the provisions of sections 47107(b) and 47133 of this title (and any other law, regulation, or grant assurance) to the extent necessary to permit the sponsor to recover from the sale or lease of the airport such amount as may be approved – (i) in the case of a primary airport, by at least 65 percent of the scheduled air carriers serving the airport and by scheduled and nonscheduled air carriers whose aircraft landing at the airport during the preceding calendar year, had a total landed weight during the preceding calendar year of at least 65 percent of the total landed weight of all aircraft landing at the airport during such year; or (ii) in the case of a nonprimary airport, by the Secretary after the airport has consulted with at least 65 percent of the owners of aircraft based at that airport, as determined by the Secretary.”<sup>84</sup></p>

<sup>82</sup> 49 U.S.C. § 47107(b)(1).

<sup>83</sup> 49 U.S.C. § 47133(a).

<sup>84</sup> 49 U.S.C. § 47134(b)(1)(A).

<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>“In its review of such a proposal [to privatize outside the APPP], the FAA would condition its approval of the transfer on the parties’ assurances that the proceeds of sale will be used for the purposes permitted by the revenue-use requirements of 49 U.S.C. §§ 47107(b) and 47133.”<sup>85</sup></p> <p>“The FAA may not exempt the public sponsor from the requirements of Grant Assurance 25, <i>Airport Revenues</i>. Accordingly, the public sponsor may use the proceeds from the sale or lease of the airport only for purposes stated in 49 U.S.C. § 47107(b) and § 47133.”<sup>86</sup></p>
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<sup>85</sup> *Policy and Procedures Concerning the Use of Airport Revenue*, § III(C)(3), 64 Fed. Reg. at 7717.

<sup>86</sup> FAA Order 5190.6B, § 6.15(c)(2).

**IS A PUBLIC AIRPORT OWNER REQUIRED TO REINVEST OR REPAY FEDERAL GOVERNMENT WHEN SELLING OR LEASING PROPERTY ACQUIRED WITH “FEDERAL ASSISTANCE”?**

<p><b>GENERAL LEGAL STANDARD</b></p>	<p><i>Land Acquired Through Surplus Property Act</i> – “The Administrator does not issue a release under this part if it would allow the sale of the property concerned to a third party, unless the public agency concerned has obligated itself to use the proceeds from the sale exclusively for developing, improving, operating, or maintaining a public airport.”<sup>87</sup></p> <p><i>Land Acquired for Airport Development</i> - “The Secretary of Transportation may approve an application under this subchapter for an airport development project grant only if the Secretary receives written assurances, satisfactory to the Secretary, that if an airport owner or operator has received or will receive a grant for acquiring land and – (B) if the land was or will be acquired for an airport purpose (except a noise compatibility purpose) - . . . (iii) the part of the proceeds from disposing of the land that is proportional to the Government’s share of the cost of acquiring the land will be reinvested, on application to the Secretary, in another eligible airport development project the Secretary approves under this subchapter or paid to the Secretary for deposit in the [Airport and Airway Trust] Fund if another eligible project does not exist.”<sup>88</sup></p> <p><i>Land Acquired for Noise Compatibility</i> – “(A) if the land was or will be acquired for a noise compatibility purpose - . . . (iii) the part of the proceeds from disposing of the land that is proportional to the Government’s share of the cost of acquiring the land will be paid to the Secretary for deposit in the Airport and Airway Trust Fund established under section 9502 of the Internal Revenue Code of 1986 (26 U.S.C. 9502) or, as the Secretary prescribes, reinvested in an approved compatibility project, including the purchase of nonresidential buildings or property in the vicinity of residential buildings or property previously purchased by the airport as part of a noise compatibility program.”<sup>89</sup></p> <p><i>DOT Common Rule</i> – “When real property is no longer needed for the originally authorized purpose, the grantee or subgrantee will request disposition instructions from the awarding agency. The instructions will provide for one of the following alternatives: . . . (2) Sale of property. Sell the property and compensate the awarding agency. The amount due to the awarding agency will be calculated by applying the awarding agency’s percentage of participation in the cost of the original purchase to</p>
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<sup>87</sup> 14 C.F.R. § 155.7(b). See also FAA Order 5190.6B, § 22.17(e) (Application of Proceeds from the Sale of Surplus Real Property).

<sup>88</sup> 49 U.S.C. § 47107(c)(2). See also FAA Order 5190.6B, § 22.18 (Release of Federal Obligations in Regard to Real Property Acquired with Federal Grant Assistance).

<sup>89</sup> 49 U.S.C. § 47107(c)(2)(A).



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	the proceeds of the sale after deduction of any actual and reasonable selling and fixing-up expenses.” <sup>90</sup>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	“The Secretary may grant an exemption to a sponsor from the provisions of sections 47107 and 47152 of this title (and any other law, regulation, or grant assurance) to the extent necessary to waive any obligation of the sponsor to repay to the Federal Government any grants, or to return to the Federal Government any property, received by the airport under this title, the Airport and Airway Improvement Act of 1982, and any other law.” <sup>91</sup>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	“It is not necessary for the public sponsor to return to the FAA the unamortized value of grant-funded projects or surplus or non-surplus property received from the federal government, as long as the grant-funded facilities and donated property continue to be used for the original airport purposes. To assure this continued use, the private operator should be required to agree specifically to continue the airport uses of grant-funded facilities and federally donated property for the purposes described in FAA grant agreements and property deeds.” <sup>92</sup>

<sup>90</sup> 49 C.F.R. § 18.31(c).

<sup>91</sup> 49 U.S.C. § 47134(b)(2).

<sup>92</sup> FAA Order 5190.6B, § 6.15(c)(3).

<b>IS A PUBLIC AIRPORT OWNER PERMITTED TO USE SALE OR LEASE PROCEEDS TO REPAY THE GENERAL FUND FOR PRIOR CONTRIBUTIONS TO THE AIRPORT?</b>	
<b>GENERAL LEGAL STANDARD</b>	<p>“[A]ny request by a sponsor or any other governmental entity to any airport for additional payments for services conducted off of the airport or for reimbursement for capital contributions or operating expenses shall be filed not later than 6 years after the date on which the expense is incurred; and any amount of airport funds that are used to make a payment or reimbursement as described in subparagraph (A) after the date specified in that subparagraph shall be considered to be an illegal diversion of airport revenues that is subject to subsection (n) [Recovery of Illegally Diverted Funds].”<sup>93</sup></p> <p>“A sponsor may use its airport revenue to repay funds contributed to the airport from general accounts or to repay loans from the general account to the airport provided the sponsor makes its request for reimbursement within six (6) years of the date on which it made the contribution.”<sup>94</sup></p>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	Public owner may seek an exemption from the prohibition on revenue diversion in accordance with 49 U.S.C. § 47134(b)(1) (quoted above). General rule would apply where the public airport owner did <i>not</i> request or receive an exemption from the prohibition on revenue diversion.
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	General rule applies. Reimbursement subject to six-year statute of limitations.

<sup>93</sup> 49 U.S.C. § 47107(f)(5).

<sup>94</sup> FAA Order 5190.6B, § 15.9(c). *See also Policy and Procedures Concerning the Use of Airport Revenue*, § V(A)(4).

**WHAT RESTRICTIONS APPLY TO PRIVATE OPERATOR'S USE OF REVENUE GENERATED FROM AIRPORT?**

<p><b>GENERAL LEGAL STANDARD</b></p>	<p>"The rules of airport revenue apply to a public or private airport that has received federal financial assistance (as defined in paragraph 15.8 of this chapter) and the federal obligations for use of airport revenue incurred as a result of that assistance were in effect on or after October 1, 1996."<sup>95</sup></p>
<p><b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b></p>	<p>"The Secretary may grant an exemption to a purchaser or lessee from the provisions of sections 47107(b) and 47133 of this title (and any other law, regulation, or grant assurance) to the extent necessary to permit the purchaser or lessee to earn compensation from the operations of the airport."<sup>96</sup></p>
<p><b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b></p>	<p>"The transfer will not be approved unless the private operator agrees to assume all of the existing obligations of the public sponsor under the grant agreements and surplus and nonsurplus property deeds. For future grants, the private operator will agree to the assurances applicable to a private operator, but initially will also be obligated to comply with the public operator's assurances as long as they would have remained in effect for the public operator."<sup>97</sup></p>

<sup>95</sup> FAA Order 5190.6B, § 15.7(a)(3).

<sup>96</sup> 49 U.S.C. § 47134(b)(3).

<sup>97</sup> FAA Order 5190.6B, § 6.15(c)(1).

**WHAT RESTRICTIONS APPLY TO PRIVATE OPERATOR’S IMPOSITION OF RATES AND CHARGES?**

<p><b>GENERAL LEGAL STANDARD</b></p>	<p>“[A] State or political subdivision of a State may levy or collect - . . . (2) reasonable rental charges, landing fees, and other service charges from aircraft operators for using airport facilities of an airport owned or operated by that State or subdivision.”<sup>98</sup></p> <p>“The Secretary of Transportation may approve a project grant application under this subchapter for an airport development project only if the Secretary receives written assurances, satisfactory to the Secretary, that –</p> <p>(2) air carriers making similar use of the airport will be subject to substantially comparable charges –</p> <p>(A) for facilities directly and substantially related to providing air transportation”<sup>99</sup></p>
<p><b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b></p>	<p>“[T]he sponsor shall not be prohibited from -- . . . collecting reasonable rental charges, landing fees, and other service charges from aircraft operators under section 40116(e)(2) of this title.”<sup>100</sup></p> <p>“The Secretary may approve an application under subsection (b) only if the Secretary finds that the sale or lease agreement includes provisions satisfactory to the Secretary to ensure the following:</p> <p>. . .</p> <p>(4) Every fee of the airport imposed on an air carrier on the day before the date of the lease of the airport will not increase faster than the rate of inflation unless a higher amount is approved – (A) by at least 65 percent of the air carrier serving the airport; and (B) by air carriers whose aircraft landing at the airport during the preceding calendar year had a total landed weight during the preceding calendar year of at least 65 percent of the total landed weight of all aircraft landing at the airport during such year.</p> <p>(5) The percentage increase in fees imposed on general aviation aircraft at the airport not exceed the percentage increase in fees imposed on air carriers at the airport.”<sup>101</sup></p> <p>“In evaluating the reasonableness of a fee imposed by an airport receiving an</p>

<sup>98</sup> 49 U.S.C. § 40116(e).

<sup>99</sup> 49 U.S.C. § 47107(a)(2). *See also*, DOT/FAA, *Policy Regarding Airport Rates and Charges*, 61 Fed. Reg. 31994 (1996) *vacated in part by Air Transport Ass’n v. DOT*, 119 F.3d 38, *amended by* 129 F.3d 625 (D.C. Cir. 1997).

<sup>100</sup> 49 U.S.C. § 47134(g).

<sup>101</sup> 49 U.S.C. § 47134(c).

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	exemption under section 47134 of this title, the Secretary shall consider whether the airport has complied with section 47134(c)(4).” <sup>102</sup>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>Private operator would <i>not</i> be subject to Anti-Head Tax Act, but would be subject to Grant Assurances, for at least the duration of the last agreement binding on the public owner and perhaps longer if private operator sought and received grants from the discretionary fund.</p> <p>In the 1996 Policy Regarding Airport Rates and Charges, DOT provided that “a private equity owner of an airport can include a reasonable return on investment in the airfield”, but conditioned this authority by stating, “A private equity owner of an airport who has included a reasonable rate of return element in the rate base may not include an imputed interest charge as well.”<sup>103</sup> However, these portions of the Policy were vacated by the U.S. Court of Appeals.<sup>104</sup></p>

<sup>102</sup> 49 U.S.C. § 47129(a)(4).

<sup>103</sup> *Policy Regarding Airport Rates and Charges*, §§ 2.4 and 2.4.1(a).

<sup>104</sup> *Air Transport Ass’n of Am. v. DOT*, 119 F.3d 38, amended by 129 F.3d 625 (D.C. Cir. 1997).

<b>IS A PRIVATE OPERATOR ELIGIBLE FOR APPORTIONMENT FROM AIP ENTITLEMENT FUND?</b>	
<b>GENERAL LEGAL STANDARD</b>	Private operators are <i>not</i> eligible for apportionment of entitlement funds pursuant to 49 U.S.C. § 47114.
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	“Notwithstanding that sponsor of an airport receiving an exemption under subsection (b) is not a public agency, the sponsor shall not be prohibited from . . . (2) receiving apportionments under section 47114 of this title . . .” <sup>105</sup>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	“The private operator will be subject to the general AIP criteria for grants to private operators, and will not be subject to or benefit from the special provisions of the airport privatization pilot program. Accordingly, the private operator should be advised that it will not be eligible for apportionment of entitlement funds under 49 U.S.C. § 47114(c) . . .” <sup>106</sup>

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<sup>105</sup> 49 U.S.C. § 47134(g).

<sup>106</sup> FAA Order 5190.6B, § 6.15(c)(5).

<b>IS A PRIVATE OPERATOR ELIGIBLE FOR GRANTS FROM AIP DISCRETIONARY FUND?</b>	
<b>GENERAL LEGAL STANDARD</b>	<p>“The [discretionary] fund is available for making grants for any purpose for which amounts are made available under section 48103 of this title that the Secretary considers most appropriate to carry out this subchapter.”<sup>107</sup></p> <p>“[Private Airport Owner] may be an individual, a partnership, corporation, etc., that owns a public-use airport used or intended to be used for public purposes that is a reliever airport or an airport that has at least 2,500 passenger boardings each year and receives scheduled passenger aircraft service.</p> <p>A privately owned airport sponsor, as defined in a. above, is eligible for funding for: (1) Airport development projects; (2) Airport master planning; (3) Noise compatibility planning; and (4) Noise program implementation projects.”<sup>108</sup></p> <p>Federal share of project cost will be 75% or 90% depending on the NPIAS status of the airport.<sup>109</sup></p>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	<p>“The United States Government’s share of allowable projects costs is – . . . (4) 70 percent for a project funded by the Administrator from the discretionary fund under section 47115 at an airport receiving an exemption under section 47134 . . .”<sup>110</sup></p>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>General rule applies. Private operator meeting FAA’s definition may apply for grants from discretionary fund for eligible projects.</p>

<sup>107</sup> 49 U.S.C. § 47115(b).

<sup>108</sup> FAA Order 5100.38C, *Airport Improvement Program Handbook*, § 208 (2005).

<sup>109</sup> See 49 U.S.C. § 47109(a).

<sup>110</sup> 49 U.S.C. § 47109(a).

<b>IS A PRIVATE OPERATOR AUTHORIZED TO IMPOSE A PASSENGER FACILITY CHARGE?</b>	
<b>GENERAL LEGAL STANDARD</b>	<p>No authority to impose PFC.</p> <p>49 U.S.C. § 40117(b) provides that the Secretary may authorize an “eligible agency” to impose a passenger facility fee. Section 40117(a)(2) defines an “eligible agency” to mean “a public agency that controls a commercial service airport.”</p>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	<p>“Notwithstanding that the sponsor of an airport receiving an exemption under subsection (b) is not a public agency, the sponsor shall not be prohibited from – (1) imposing a passenger facility fee under section 40117 of this title . . .”<sup>111</sup></p>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>“[T]he private operator should be advised that it will not be eligible . . . for imposition of a passenger facility charge at the airport.”<sup>112</sup></p>

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<sup>111</sup> 49 U.S.C. § 47134(g).

<sup>112</sup> FAA Order 5190.6B, § 6.15(c)(4).



**IS A PRIVATE OPERATOR REQUIRED TO SEPARATELY OBTAIN AN AIRPORT OPERATING CERTIFICATE?**

<p><b>GENERAL LEGAL STANDARD</b></p>	<p>“The Administrator of the Federal Aviation Administration shall issue an airport operating certificate to a person desiring to operate an airport – (1) that serves an air carrier operating aircraft designed for at least 31 passenger seats; (2) that is not located in the State of Alaska and serves any scheduled passenger operation of an air carrier operating designed for more than 9 passenger seats but less than 31 passenger seats; and (3) that the Administrator requires to have a certificate; if the Administrator finds, after investigation, that the person properly and adequately is equipped and able to operate safely under this part and regulations and standards prescribed under this part.”</p>
<p><b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b></p>	<p>“FAA operating certificates are not transferable; a new operator of a certified airport must obtain a new certificate issued by the FAA.”<sup>113</sup></p>
<p><b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b></p>	<p>“As with any change of airport owner/operator, FAA certificates do not transfer. If the airport is certificated under 14 CFR Part 139, that certification will not transfer to the private operator and would need to be reissued.”<sup>114</sup></p>

<sup>113</sup> FAA, *Notice of Final Application Procedures*, 62 Fed. Reg. 48693, 48694 (1997).

<sup>114</sup> FAA Order 5190.6B, § 6.15(c)(5).

<b>IS A PRIVATE OPERATOR REQUIRED TO MAINTAIN AN AIRPORT SECURITY PROGRAM?</b>	
<b>GENERAL LEGAL STANDARD</b>	<p>“No person may operate an airport subject to Sec. 1542.103 unless it adopts and carries out a security program that – (1) Provides for the safety and security of persons and property on an aircraft operating in air transportation or intrastate air transportation against an act of criminal violence, aircraft piracy, and the introduction of an unauthorized weapon, explosive, or incendiary onto an aircraft; (2) Is in writing and is signed by the airport operator; (3) Includes the applicable items listed in Sec. 1542.103; (4) Includes an index organized in the same subject area sequence as Sec. 1542.103; and (5) Has been approved by TSA.”<sup>115</sup></p> <p>Section 1542.103 imposes distinct requirements for “complete”, “supporting” and “partial” security programs, based on the nature of operations by air carriers and foreign air carriers.</p>
<b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b>	<p>49 U.S.C. § 47134 does not specifically address security requirements. Section 47134(c)(6) provides that, as a condition of approval, the Secretary must be satisfied that “[s]afety and security at the airport will be maintained at the highest possible levels.”</p>
<b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b>	<p>“[I]f the airport has a security plan in effect in accordance with Transportation Security Administration (TSA) regulations, TSA should be advised of the request for approval of the transfer of airport management responsibility. TSA will advise the airport sponsor if additional amendments are necessary.”<sup>116</sup></p>

<sup>115</sup> 49 U.S.C. § 1542.101(a).

<sup>116</sup> FAA Order 5190.6B, § 6.15(c)(5).

**IS THE PUBLIC OWNER OR PRIVATE OPERATOR OBLIGATED TO PROVIDE LAW ENFORCEMENT AT AIRPORT UPON TRANSFER?**

<p><b>GENERAL LEGAL STANDARD</b></p>	<p>“[E]ach airport operator required to have a [complete or supporting security program] must provide: (1) law enforcement personnel in the number and manner adequate to support its security program.</p> <p>Each airport required to have a [partial security program] must ensure that: (1) Law enforcement personnel are available and committed to response to an incident in support of a civil aviation security program when requested by an aircraft operator or foreign air carrier that has a security program under part 1544 or 1546 of this chapter.”<sup>117</sup></p>
<p><b>AIRPORT PRIVATIZATION PILOT PROGRAM, 49 U.S.C. SEC. 47134</b></p>	<p>49 U.S.C. § 47134 does not specifically address security requirements. Section 47134(c)(6) provides that, as a condition of approval, the Secretary must be satisfied that “[s]afety and security at the airport will be maintained at the highest possible levels.”</p>
<p><b>LEGAL STANDARD APPLIED TO PRIVATIZATION NOT UNDER PILOT PROGRAM</b></p>	<p>“[I]f the airport has a security plan in effect in accordance with Transportation Security Administration (TSA) regulations, TSA should be advised of the request for approval of the transfer of airport management responsibility. TSA will advise the airport sponsor if additional amendments are necessary.”<sup>118</sup></p>

<sup>117</sup> 49 C.F.R. § 1542.215.

<sup>118</sup> FAA Order 5190.6B, § 6.15(c)(5).

## **Appendix G**

### **Key Stakeholder Interests and Concerns**

#### **G.1 Introduction**

As public entities, airport owners face competing demands from various stakeholders who could be affected by a change in activities that were once performed by government that are turned over to private entities. It is important to understand how these key parties perceive the change in operation and how it might affect their use of the airport. Therefore, key stakeholder groups were surveyed to document their issues and concerns regarding privatization and their perspectives on the potential advantages and disadvantages.

#### **G.2 Survey Approach**

The following venues were used to solicit input from the stakeholder groups:

- *Policy Makers* – A focus group was held with the ACI-NA ACI Commissioners’ Committee at the annual ACI-NA conference held in Pittsburgh on September 26, 2010. The director of News Orleans International Airport was also interviewed regarding the decision to withdraw from the Airport Privatization Pilot Program and associated documents were obtained. Information from the literature review was also used.
- *U.S. Airport Management* – A focus group discussion was held with the ACI-NA Board and other airport CEOs at the annual ACI-NA conference. In addition, various one-on-one structured interviews were conducted with other senior level airport managers, including information from airport managers in support of the case studies.
- *International Airports* – Interviews were conducted with representatives from various European and other overseas airport operators, including MAp Airports representative, BAA airport management, Gatwick Airport management, and Sydney Airport management. In addition, structured interviews were conducted with representatives of the UK Competition Commission and UK’s airport regulator, the Civil Aviation Authority, which were augmented with literature searches.
- *Airlines* – Interviews were held with representatives of the Air Transport Association, American Airlines, Southwest Airlines, and several international airlines. Airline input was also received through participation in the AAAE National Airports Conference in San Diego, September 20, on a panel entitled “Destination Privatization: The Future of Public/Private Partnerships.” The panel moderated by Erin O’Donnell (Managing Deputy Commissioner of Chicago Midway Airport) and participants included Michael Aubuchon (Southwest Airlines), Kevin Willis (FAA), and Sheri Ernico (LeighFisher). Published literature was also reviewed.
- *USDOT/FAA* – A focus group discussion was held with representatives from the Office of the Secretary of Transportation of the USDOT and FAA Airports division. Members of the research team also participated in a panel on airport privatization at the AAAE Basics of Airport Law, which was held on September 13 in Washington, D.C., which included Nancy Kessler (USDOT OST) and Kevin Willis (FAA/Compliance). Dan Reimer of Kaplan Kirsch & Rockwell was moderator and Sheri Ernico (of LeighFisher) participated.

- *Private Airport Operators* – Interviews were conducted with representatives from various private airport management firms, including LCOR, YVR Airport Services Ltd., Houston Airport System Development Corporation (HASDC), Aviation Facilities Company, Inc. (AFCO), MAp Airports, and Sydney Airport management.
- *Lenders* – Interviews were conducted with representatives from parties that have lead financial proposals for airport privatizations, including MAp Airports and Crédit Agricole CIB.
- *Investors* – Interviews were conducted with representatives from Sydney Airport investor, Gatwick Airport acquirer representative, adviser to Gatwick bidder, Global Infrastructure Partners, Hochtief AirPort, MAp Europe. We also relied upon information from LeighFisher’s extensive experience of interacting with financial institutions in the context of airport privatizations.
- *Financial Advisors* – Firms advising airports on the “sell side” were contacted, including Mayer Brown and Infrastructure Capital Advisors LLC.
- *Rating Agencies* – Rating methodology for non-US airports was provided by Fitch, Moody’s, and S&P and interviews were conducted.
- *Labor* – Interviews were conducted with the President and Secretary-Treasurer of the Transportation Trades Department (“TTD”), AFL-CIO, which represents the voice of transportation workers through its 32 member unions. Among the largest of these unions with significant numbers of aviation employees are the:
  - Airline Pilots Association
  - American Federation of State, County and Municipal Employees
  - Association of Flight Attendants-CWA
  - International Association of Fire Fighters
  - International Association of Machinists and Aerospace Workers
  - National Air Traffic Controllers Association
  - Professional Aviation Safety Specialists
  - Transport Workers Union of America

In addition, TTD works with counterpart offices within the AFL-CIO to ensure that the interests of other workers, including most notably airport concession, construction workers and airport security screeners are met as well.

- *Passengers/Community* – To gauge the possible effects of privatization on passengers and the local community, the research team reviewed reports, publications, and passenger surveys as well as information derived from the case studies.

Appendix G-1 is a list of participants and organization that participated in this outreach effort. Specific input is described in the following sections.

### G.3 Policy-Makers

Policy makers, including appointed and elected officials, have the ultimate say in privatization choices and decisions. Policy-makers may have competing, and sometimes unrealistic views, compared with airport management, and may be lobbied heavily by other stakeholders pursuing their own interests. At the same time, they recognize that airports are strategic assets and have the potential to deliver long-term value to the local economy. Losing control over that asset can be a vexing decision for policy-makers. In addition, there is not always consensus among policy-makers on the merits of privatizing their airport.

One of the primary motivations for airport privatization from policy-makers may be to derive cash proceeds from the sale or long-term lease of the airport either through an up-front payment or annual payments. As best described by Paul Volpe, the chief financial officer for the city of Chicago, regarding the Midway transaction:<sup>1</sup>

*“Just as with the long-term lease of the Chicago Skyway, if we successfully conclude this transaction, the taxpayers of Chicago will benefit through a substantial payment to the city that we can use to enhance quality of life for our residents.”*

As noted by the U.S. Government Accounting Office in its 1996 report:<sup>2</sup>

*“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.”*

However, diverting airport lease or sale proceeds is prohibited under federal law without airline approval, and this can only be accomplished under the APPP. Often there is tension between the desire for money from the lease and not wanting to turn over a public asset to the private sector.

Some policy-makers have considered privatizing their airports due to an ideological conviction and belief that the private sector can do a better job of managing airports by improving the efficiency of operations, establishing new retail and restaurant operations, introducing creativity and innovation, and enjoying lower construction costs. Ideology played a role in the privatization of the UK airports in 1987 under Margaret Thatcher’s administration, which launched the airport privatization trend. It also seemed to play a key role in the privatization efforts that were documented in the case studies for Boston Logan Terminal A, Indianapolis, JFK IAT, and Stewart. For Boston Logan, the political imperative came from Governor Weld who was committed to establishing Massachusetts as a leader in privatization. This in turn caused the Massachusetts Port Authority to begin considering alternatives for private sector participation in its operations. For JFK IAT and Stewart, Governor Pataki was pressing for privatization. In Indianapolis, Mayor Goldsmith pursued many privatization initiatives for the city and exercised his influence over the airport authority’s decision to pursue “managed competition” for its airport system.

For example, as explained at a Bond Buyer conference in November 2010, by David Alvarez,

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<sup>1</sup> Yvette Shields, *Chicago Issues RFQ for Midway Airport*, The Bond Buyer, February 14, 2008.

<sup>2</sup> U.S. Government Accounting Office, *Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports*, Report to the Subcommittee on Aviation, Committee on Transportation and Infrastructure, House of Representatives, GAO/RCED-97-3, November 1996.

executive director of the Puerto Rico Public-Private Partnerships Authority, regarding Puerto Rico’s APPP application for San Juan’s Luis Munoz Marin Airport:

*“We believe that it is an airport with unrealized potential. We believe we can take it to the next level by partnering with a private concession.”*<sup>3</sup>

In Mr. Alvarez’s presentation, he listed the benefits of privatizing Luis Munoz Marin Airport to the various stakeholders:<sup>4</sup>

<b>Commonwealth</b>	<ul style="list-style-type: none"> <li>▪ Re-position Puerto Rico as a preferred destination in the Caribbean</li> <li>▪ Increase passengers and carriers, which increases jobs and visitors’ spending</li> <li>▪ Higher infrastructure investment in airport facilities</li> <li>▪ Reduction of operating expenses for Ports Authority</li> <li>▪ Fiscal and credit strengthening for Ports Authority</li> </ul>
<b>Traveling Public</b>	<ul style="list-style-type: none"> <li>▪ Operator will be motivated to ensure high-quality traveler experience</li> <li>▪ Best in class operations will continue to attract top airlines</li> <li>▪ Long-term development and improved strategic planning</li> </ul>
<b>Airlines</b>	<ul style="list-style-type: none"> <li>▪ Potentially lower net airport charges</li> <li>▪ Greater visibility, transparency and predictability of airport charges</li> <li>▪ Economic risk shifted from airlines to operator</li> <li>▪ Improved service quality and infrastructure ensured by new operating standards</li> <li>▪ World class operator will deliver global best practices</li> <li>▪ To create an operating environment that encourages increased passenger traffic</li> </ul>

Mr. Alvarez stressed that the privatization is: “More than a transaction, it is an economic development measure for Puerto Rico.”

Some policy-makers turn to privatization out of frustration. For example, the former mayor of New Orleans turned to the APPP out of frustration with the performance of the New Orleans International Airport and its poor reputation. It was believed that privatization would send a visible signal of change to the community. However, under the oversight of a new mayor, new aviation authority board, and new airport director, the New Orleans Aviation Authority decided to withdraw from the APPP by noting:<sup>5</sup>

*“After analyzing the conditions required to effectively privatize public infrastructure and the current state of capital markets, it has been concluded that New Orleans is not well positioned at this point in time to solicit bids for privatizing the Louis Armstrong International Airport. Rather, the airport is better served by focusing on its recently announced initiatives to improve operations and become a more effective asset for the City of New Orleans and the State of Louisiana. The Louis Armstrong New Orleans International Airport is thus withdrawing from the FAA Airport Privatization Pilot Program.”*

The community was devastated by Hurricane Katrina and is going through an economic transformation and rebuilding process. In this context, the policy-makers seemed concerned about losing control over the development of the airport, which they believe is a strategic and key asset

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<sup>3</sup> Shelly Sigo, *Prospects Still Solid for Airport P3s*, The Bond Buyer, November 10, 2010.

<sup>4</sup> David Alvarez, Puerto Rico Airport PPP Update & Perspectives, Bond Buyer Transportation Finance/P3 Conference, November 10, 2010.

<sup>5</sup> New Orleans Aviation Board, *Louis Armstrong New Orleans International Airport Withdraws from FAA Airport Privatization Pilot Program*, Press Release, October 21, 2010.

that is contributing to the rebuilding of the regional economy. In a report to policy-makers, the consultant advising the New Orleans Aviation Authority commented:<sup>6</sup>

*“Our research indicates that a private company will ask for control and independence before agreeing to a long-term lease of the airport. This arrangement would put a large amount of the region’s economic potential within the jurisdiction of a private company...The New Orleans Aviation Board has recently announced steps to take the Airport in a new direction. This new direction appears to be focused in the areas of operations, infrastructure, and finance...Privatizing the airport at this time could disrupt progress, putting this economic impact at risk.”*

Because New Orleans International Airport is the only commercial service airport serving the region, there was a concern that under private operation there would be no checks and balances if the private operator encountered financial trouble. The tourism industry was one of the key stakeholders that participated in the review, and was concerned about the implications of turning the airport over to a private entity. New Orleans’ tourism-based economy benefits from low air fares. Because tourist travel is discretionary and sensitive to cost, the airport and its stakeholders were concerned that higher airline costs that might come under private operation could discourage low cost airlines from adding service to the airport.

The ACI-NA Commissioners Committee allocated time to the research team to provide input for the study. The committee members represented a diversity of airports, including a large connecting hub airport, a medium hub airport, small and non-hub airports, and a general aviation airport. The Commissioners also asked the following questions:

- Why would U.S. airports consider privatization if airports are the economic engine for the region?
- Would private owners have the same desires for the community vs. the bottom line profit motive of the private sector? In particular, they were concerned that private operators may not embrace goals that are consistent with the needs and values of the local community.
- Should the U.S. consider the Canadian model of airport commercialization instead?

One committee member commented that private development on general aviation airports should be better exploited.

Another consideration for policy-makers is execution risk, in particular, the potential for risk to their political career if a privatization goes poorly.

#### **G.4 U.S. Airport Management**

A focus group meeting was conducted at the ACI-NA annual conference in November 2010 that was attended by ACI-NA Board members and airport CEOs representing the full spectrum of airports in terms of size, governance, and number of airports in the system, including:

- Size -- 5 large hubs, 3 medium hubs, 1 small hub, 1 general aviation, and 1 Canadian
- Governance – 2 port districts, 4 single purpose airport authorities, 3 municipal/city departments, 2 county departments, and 1 non-profit corporation (Canada)
- Multiple airports in system – 5 of the public entities operate multiple airports in a system

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<sup>6</sup> Vik Bhatia, Memo to New Orleans Aviation Board, MSY Privatization, Boston Consulting Group, October 8, 2010.



In addition, airport managers from two other medium hub airports were interviewed. Some of the themes that came out of the focus group and one-on-one interviews with senior level airport managers include:

***Views on the Airport Privatization Pilot Program (APPP):***

- APPP is not “true” privatization – it is good for private operators, allows communities to cash-out value (“borrow against the future”), and is good for airlines, but the constraints are significant. The APPP does not come close to resembling the international privatization experience.
- The requirement for 65% airline approval puts the airlines back in control of airports. Airlines lost control of airports after long-term residual agreements transitioned into compensatory systems at O&D airports. Airlines feel like they have no control over passenger facility charges (“PFCs”) and see the APPP as a way to regain some ground.
- It is not surprising that interest in the APPP is tepid.
- Airport managers expressed concerned that the financial incentives for elected officials could prompt them to lobby for a change in federal law to allow for more widespread privatization of large airports where municipalities would be able to more readily cash-out on their airports for the wrong reasons.
- The future of APPP is uncertain given the changing political landscape in Washington, D.C. One key development since the focus group meeting is that the key congressman who expressed concerns over public-private partnerships (U.S. Rep. James L. Oberstar, D-Minnesota) failed to be re-elected in November 2010 and the House transportation leadership is now controlled by Rep. John Mica (of Florida) who supports public-private partnerships.
- At least one airport manager believes that a long-term lease under the APPP is one of the few opportunities for the municipality to cash-in on a government-owned asset that benefits the entire region since people in the region enjoy municipality’s assets without paying for them.

***Regarding Midway***

- The Midway transaction would have allowed the city of Chicago to borrow against the future. Airport managers were concerned about the longer term implications of the transaction on the ability for Midway to serve the needs of the community.
- For some airport managers, the biggest fear of the attempted Midway transaction was that elected officials will look at the winning bid amount and be enticed to privatize for the wrong reasons (i.e., large upfront payment).
- The Midway transaction was proposed almost entirely for the upfront payment. It was not pursued because of the lack of competence of its management team.
- Another concern was that the airlines got a “sweetheart deal” at Midway that will serve as the baseline for all future privatization transactions. The bottom line is the airlines control the leverage under the APPP because airline approval is needed for the government to cash-out on the airport and this means a compromise.

### ***Implications of Emerging Domestic Trends***

- The potential for a cash-out payment is attractive to politicians that do not currently receive financial benefits from airports because of the prohibition on revenue diversion. The financial situation for municipalities is expected to get worse as they run out of ways to raise funds for pensions, capital improvements, and ongoing operations. However, because valuations are much lower today, most people are taking a wait-and-see approach.
- A confluence of factors is likely to force U.S. airport owners to explore privatization in the not-too-distant future, including loss of tax-exempt financing (due to expanding federal deficits), reductions in AIP funding, and no increase in PFC level. These unfolding trends are likely to influence the future of the APPP statute
- Therefore, there may be need for “true privatization” in the U.S. for reasons beyond realizing a cash infusion for the public owner.

### ***Successful Public-Private Partnerships***

- Several examples were provided of P3s being employed to successfully develop projects (e.g., solar, consolidated rental car facility).

### ***Airline Consortiums***

- *Airline equipment* – Some airport managers are unhappy with the way airlines maintain equipment (e.g., baggage systems, loading bridges, etc.). They also believe that the only reason the airlines might be able to perform this function cheaper is by not maintaining the systems to the same performance standard or level. At least two large airports described how they took over the maintenance of airline systems to improve upon its performance because they were tired of being criticized for broken equipment they were not responsible to maintain. By contrast, airlines noted instances where private entities such as airline consortiums can do a better and cheaper job of maintaining and operating airline equipment. One interpretation of these contrasting views might be that private entities, other than individual airlines, might be able to do a good job maintaining and operating airline systems if held to specific performance standards.
- *Fuel consortium* – Airport managers say the airlines claim they cannot raise capital themselves to fund fuel system improvements and therefore approach airports for conduit financing on behalf of airline fuel consortiums. In the ACI-NA Legal Affairs Committee there was an extensive discussion about the shell nature of fuel consortiums and the associated risks involved.

### ***Public Management is as Good as Private***

- There was strong sentiment that U.S. airport managers can do as good a job, if not better, than private operators if they were unburdened by cumbersome, rigid regulations and processes. Nevertheless, some airport managers expressed frustration with the lack of speed when undertaking public projects and the inherent problems associated with the requirement to accept the lowest bid. With a public-private partnership, the government can avoid the low bid, move faster, get better quality control, and still meet DBE goals.
- Initially the interest in privatization at the international level was driven by a need to access funding for capital improvements. Because public airports in the U.S. have access to tax-

exempt debt, they can borrow money cheaper than the private sector, and are therefore in a position to make greater profits and offer lower user fee costs.

- Some airport managers asked “why send money off airport” to a private entity?
- The airport managers acknowledged that there are efficiencies to be gained from being able to manage all employees (i.e., ability to shift employees to where they are needed).

### ***Examples of “Reverse Privatization”***

- Naples – The airport owner also performs the functions of an FBO, and exercises its proprietary exclusive rights to earn a profit to be plowed back into airport development. The primary limitation to providing better services is grant assurances.
- Pittsburgh – The airlines neglected to maintain airport-owned airline equipment (loading bridges, baggage devices, FIDS) so the airport staffed up to take over all maintenance and rebuild the systems. After US Airways pulled-down its Pittsburgh hub leaving vacant gates, the airport began to offer loading bridge maintenance services to a private company.
- Las Vegas owns, operates, and controls all baggage handling systems and all common use systems (CUSS and CUPPS). When the airport purchased the systems from the airlines they were in a state of disrepair. When these systems fail, the airport gets blamed even if it is the airline’s responsibility. This motivated the airport to take over operation and maintenance of these systems. Airports have a longer term perspective than airlines.
- Similarly, the Metropolitan Washington Airports Authority (“MWAA”) was selected by the Governor of Virginia to run the toll road over private operators because MWAA knows how to manage large-scale construction projects, which implies public entities are perceived to be effective at such construction.

### ***Social Discussion***

- Privatization is a social discussion because the most money from a long-term lease or sale would be generated from airports that operate the least efficiently. Airports can raise capital more efficiently because they have access to tax-exempt financing. On the other hand, private operators can engage in procurement more efficiently. There is a need to establish policies first and then design a program around those policies.
- Unlike private entities, public entities are not profit-motivated.
- Governments in the U.S. are neglecting infrastructure (e.g., roads) at the expense of social programs.

### ***Public Sector Motivations***

- U.S. airports are motivated by public safety, not profit.
- Some governing bodies are more/less risk averse. This drives decisions on private participation.
- Need to look at business relationship with airlines to see why innovation has not occurred at U.S. airports. Because airlines benefit from savings (at least in a residual rate structure), there is little motivation to take risks.

- As a number of airports have transitioned from residual to compensatory rate-making, public airport managers have been motivated to operate their airports more efficiently and be more entrepreneurial.

### ***Public Sector Constraints***

- Limitations are based more on constraints from regulations than issues about funding. Constraints include rates and charges, procurement, local business enterprise goals, etc., but public airports are still able to operate effectively.
- Biggest constraints for U.S. airports are procurement rules imposed by government, which cause inefficiencies. For example, when awarding construction contracts, most airports must choose the lowest bidder by law even though they know certain companies are “change order bandits.”
- Public policies cost more, e.g., unions, local business enterprise goals, etc.
- Public airports also serve local policy issues to benefit the local community by stimulating economic development through increased air service. Private operators do not have the community interests in mind because their only motivation is to satisfy their shareholders.
- Despite all the constraints imposed on U.S. public airports (e.g., procurement, local business enterprise goals and other social policies, rates and charges), they are still well run.
- Airport CEOs would like to see changes in the economic regulatory regime to allow public airports more freedom.

### ***Different Airports Must Consider Different Strategies***

- Airports with high levels of origin-destination (“O&D”) passengers can own, operate, and control airline systems whereas at a connecting hub this practice would not be in the airport’s interests due to the potential for an airline pull-down on capacity (e.g., US Airways dehubbing of Pittsburgh). Several airport managers indicated that it is hard to find the benefits that privatization could bring to well-managed O&D airports.
- At least one airport is facing such a large capital program they are considering third-party developers for new cargo facilities, FBO, and central receiving. Given the airport’s limited potential for growth, scarce PFCs are being preserved for airfield, terminal, and ground access improvements.
- Interest in competitive consequences of privatization for airports that operate in multi-airport regions -- would privatizing help an airport compete against other airports?

### ***Community Goals***

- Private operators will come back to change contract. There is no confidence that privatization will in fact shift risk to private enterprise.
- If airports were profit-motivated, there will likely be less activity. Then you would have airports and airlines in same position.

### ***Private New Airport Development in Branson, Missouri***

- Branson is an interesting experiment, but the jury is still out and they have already tapped into reserves.

### ***Canadian Experience***

- Airports in Canada have been corporatized meaning they are publicly owned but reorganized under local corporation laws and have far fewer federal economic restraints than in the U.S.
- In Canada, airports have become profit-centers for government.
- The Canadian federal government cashed in on airports and still demands hefty annual rent as well as continues to impose new regulations.
- The retention rate of federal employees by the local airport operators has averaged 80-85%.

## **G.5 International Airport Operators**

The survey of international airports is intended to highlight differences between U.S. airports (which tend to have similar business practices, ownership and governance models, and traffic characteristics), and airports outside the U.S., and to highlight some of the lessons learned from the worldwide privatization experiences.

There are many lessons to be learned from these experiences as documented in Task 3, some of which are summarized below as augmented from other interviews for this task.

- There is a common misunderstanding that private operators will try to “sweat the asset,” meaning they try to look for ways to cut operating and capital costs to the detriment of the users of the airport, often by deferring investment in capacity expansion. However, regulatory regimes that require the periodic submission of capital programs can prevent this situation from occurring. For example, in Australia, airport operators are required to submit 20-year capital plans to the federal government, which are updated every 5 years by the operator and approved by the government. The operator must also secure airline agreement for aeronautical capital improvements and associated rate increases and in return the operator is entitled to a return on its investment.
- Unlike in the U.S., many international airport operators believe that airline pricing schemes that charge on a per passenger basis are the most transparent and efficient systems because both airport and airline interests are aligned. In the U.S., airports tend to lease gates on a preferential use basis and charge airlines rent for the premises leased. The airlines prefer this method because it gives them more control over the gates. By comparison, international airports tend to charge for gates on a per use basis and the gates are typically available on a common use basis.
- Airlines exert more political influence over U.S. airport operators than they do for international airports.
- International airport operators believe commercial activities are more important than in the U.S. For many international airports, non-airline revenues, including concessions, are the largest source of revenue, exceeding revenues from airline charges. As a result, international

airports tend to place more emphasis on commercial space planning when designing terminals (including location, size, clustering, etc.).

- One operator commented on the negative impact of government “take backs” in regulations and mandates. These can impose unanticipated and significant costs on the operator that cannot be passed on to users. They can range from capital expenditures to requirements to offer peak hour slots to special categories of users.
- Airports are not monopolies because there is fierce competition for international passengers. Each passenger generates passenger service charges and non-aeronautical revenue, which contribute to the operator’s bottom line.
- At least one international airport operator stated that their cost structure is 20-25% lower than U.S. airports. Because most of their services are contracted out, they tend to have fewer employees than U.S. airports.
- Several international airport operators (e.g., Heathrow, Gatwick, Stansted in the UK and the Australian airports) come under surveillance by the government for customer service. They either participate in the ACI passenger survey program and/or conduct their own surveys of passengers. In the UK, airports incur service penalties if they do not meet service standards set by the regulator.
- There is ample evidence that international airport airports have invested significantly in their facilities.
- One international airport operator also noted that under the economic regulatory regimes, international airport operators are not motivated to invest in unique leading edge innovations in contrast to the newer, more modern airports, but instead tend to cautiously make investments that are very pragmatic.

## **G.6 Airlines**

As the largest and most important tenant for commercial service airports, airlines have been cautious and sometimes critical about airport privatization. In the U.S., airlines are still skeptical about privatizations, but can see some benefits if it is “done right and well.”

It is instructive to review some of the international experiences first since there is much more history in airport privatization outside the U.S.

### **G.6.1 International Airline Experience**

The UK has the longest history with airport privatization that extends back to 1987. Airlines in the UK have been critical of BAA. Part of this criticism stemmed from the common ownership of seven of the largest airports in the UK by BAA that was believed to cause adverse consequences for passengers and airlines. In 2008, the UK Competition Commission proposed that BAA sell two of its three London airports and one of either Edinburgh or Glasgow just two years after Spanish builder Grupo Ferrovial bought BAA’s seven British airports for £10 billion (\$18 billion).<sup>7</sup>

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<sup>7</sup> When BAA was sold in 2006, it owned three airports in London (Heathrow, Gatwick, and Stansted), three in Scotland (Edinburgh, Glasgow and Aberdeen), and Southampton.

Virgin Atlantic spokesman Paul Charles who does not believe that airport monopolies work in the consumer's interest commented in 2008:<sup>8</sup>

*"There is little incentive for BAA, under the current regulatory regime, to provide the best services for passengers. That is why Britain's airports need new owners and a new regulatory system that works in the consumer interest, not against it."*

British Airways and Ryanair also called for the break-up of BAA. Ferrovial came under fire from airlines for delays and poor service at Heathrow and Gatwick in its first two years of BAA ownership, culminating in the poorly managed opening of Heathrow's Terminal 5 in March 2008.

After the break-up of Gatwick, one Gatwick Airport airline representative commented on the new ownership structure:

*"An airport's ownership structure (private v. government ownership) does not have a significant impact on an airport's business or an airport's attractiveness to airlines. The key determinant is the strength of an airport's management team, and its relationship with the airport owners. In the case of Gatwick, the key change in relationship is due to the airport's move out of BAA and a new, dedicated, management being put in place."*

Airline criticism appeared to extend beyond the calls for the break-up of BAA. Andy Harrison, chief executive of UK low-cost carrier EasyJet, said:<sup>9</sup>

*"They have said what everyone knows, that our airports aren't working, and that BAA and regulation aren't working. Simply selling a monopoly airport from one greedy, highly indebted capitalist to another will benefit no one apart from the deal makers in the City."*

Indeed, British Airways would like to see the regulation of BAA's London airports strengthened by having BAA treated like a utility that is subject to tough performance criteria and sanctions if it fails to meet them.

Airlines in Australia expressed concern that the dual till regulatory regime does not provide sufficient incentive for investment in aeronautical infrastructure:

*"[The dual till approach] creates an incentive for the airport to invest in non-aeronautical infrastructure. This is currently causing a number of problems at Australian airports, including Sydney. While significant amounts of money are being spent on improving retail facilities, there is a shortage of aeronautical infrastructure such as aircraft parking facilities." (Sydney Airport airline representative)*

However, they felt a clear regulatory regime was important:

*"A clear regulatory framework is not only more attractive to the parties involved in the privatization, but is also helpful for airlines as it reduces uncertainty and enables them to plan their business in spite of the ongoing privatization." (Former Qantas representative)*

Nevertheless, the Sydney airlines felt that they were better off under private control:

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<sup>8</sup> Benet Wilson, *BAA Fined For Missing Service Goals At Heathrow, Gatwick*, Aviation Daily, October 31, 2008.

<sup>9</sup> Julia Werdigier and Mathew Saltmarsh, *Report Suggests Breakup of British Airport Operator*, New York Times, August 21, 2008.

*“Although airlines are probably better off now than they would be had the airport remained publicly owned, significant improvements remain possible, particularly with regard to the level of charges at Sydney Airport and the investment in aeronautical infrastructure.” (Sydney Airport airline representative)*

## G.6.2 U.S. Airline Experience

In the U.S. context, where airport privatization has been limited primarily to partial privatization schemes, the airlines are primarily concerned about maintaining reasonable rates and charges and are opposed to siphoning of airport revenues for non-airport purposes.

Factors affecting airlines rates include access to federal grants and tax-exempt debt, which public operators have, and property tax exemption, which public entities have but private entities do not have. Private operators under the APPP remain eligible for AIP grants, but have little or no access to tax-exempt debt. Nevertheless, private operators under the APPP are subject to rate caps, grant assurances, and the Anti-Head Tax reasonableness standard. Private operators outside the APPP are subject to the reasonableness and unjust discrimination standards of grant assurance 22. Private operators have limited or no access to tax-exempt debt under full privatizations schemes.

However, under current federal rules, the airlines receive considerable protection regarding revenue diversion and reasonable rates. A brief summary of these rules is shown in Table G.1.

**Table G.1. Summary of U.S. Economic Rules Under Partial and Full Privatization**

Factor	Partial Privatization	Full Privatization Under APPP	Full Privatization Outside APPP (per FAA Order 5190.6B)
Eligibility for AIP grants	Public entity is eligible	Private entity is eligible, but with lower discretionary federal share (70%)	Private entity is not eligible
Eligibility for tax-exempt debt	Same terms as government	No*	No*
Property tax exemption	Not applicable	Not unless special legislation	Not unless special legislation
Prohibition on revenue diversion	<ul style="list-style-type: none"> <li>▪ Government must comply</li> <li>▪ Operator exempt</li> </ul>	<ul style="list-style-type: none"> <li>▪ Government must comply unless 65% airline approval</li> <li>▪ FAA is authorized to grant an exemption to permit the private operator to “earn compensation from the operations of the airport”</li> </ul>	<ul style="list-style-type: none"> <li>▪ Government must comply</li> <li>▪ Operator permitted to be paid reasonable compensation for providing airport management services and reasonable return on capital investment**</li> </ul>
Reasonable terms, no unjust discrimination (subject to rates & charges policy)	Government and operator must comply	Operator cannot increase aeronautical rates by more than inflation without airline approval	Operator must comply

\* To qualify for federal tax-exemption, the assets being financed must satisfy the government ownership requirement that the lease term does not exceed 80% of the economic life of the asset. Also, to use tax-exempt debt to acquire an existing asset, at least 15% of the debt must be used to pay for a new asset and the proceeds must be spent within three years of the issuance.

\*\* As stated in the revenue-use policy, “The FAA expects private owners to be subject to the same requirements governing...the recovery of unreimbursed capital contributions and operating expenses from airport revenue as public



sponsors. Under section 47107(l)(5), private sponsors—like public sponsors—may recover their original investment within the six-year statute of limitation. In addition, they are entitled to claim interest from the date the FAA determines that the sponsor is entitled to reimbursement under section 47107(p). Any other profits generated by a privately-owned airport subject to section 47133 (after compensating the owner for reasonable costs of providing management services) must be applied to the capital and operating costs of the airport.”

***Full Privatization Schemes.*** Below is a summary of comments from the airlines interviewed regarding full privatization (i.e., long-term lease).

- In addition to the availability of tax-exempt debt and grants, the airlines expressed concern about private entities need to earn a return on their investment and the associated layer of cost. Would it be possible to realize sufficient savings from more efficient operations and enhanced non-aeronautical revenues to recover the operator’s costs and return on investment? Chances are this could only be accomplished at airports that are run inefficiently and/or have high “social policies” such as living wages.
- Airlines are “not for or opposed to privatization, but any deal needs to make business sense for the airlines.”
- Airlines view privatization as a viable option towards a broader goal, such as lower costs or more efficiency at an airport.
- Airport costs will play an increasing role in airline decisions concerning service expansion and higher airport costs will limit future growth opportunities.
- Given the long-term nature of the leases, airlines are concerned about controlling their costs at airports in the future. They will endeavor to do this through negotiated caps and escalators, and/or through participation in the concession agreement in some fashion.
- It is important to align the interests of the parties (government, private operator, and airlines) more closely. Rather than a large upfront payment, it might be better to structure the deal with annual payments whereby all parties benefit if the airport grows. A large upfront payment does not motivate the government beyond the transaction date and leaves all the risk to the operator and airlines. This in turn motivates the airlines to negotiate a cap on rate increases to mitigate their risk in the transaction.
- The “practicality for privatization” depends on the factual circumstances for the airport. For example:
  - Higher debt airports are less appealing candidates for privatization because the higher the debt, the higher the premium needed to payoff the debt and still realize a meaningful residual payment for the government. Moreover, the airport debt is likely to be tax-exempt while the private entity would need to replace that debt with more costly taxable debt.
  - Well run airports are not good candidates for privatization because it will be more difficult to extract cost efficiencies and uncover revenue opportunities from the future operation of the airport.
  - Airports that have problems with governance and lack operational independence might be better run under alternative structures such as privatization. There could be significant efficiencies gained if the airport is shielded from political influence.
- Therefore, some airports are better candidates than others for full privatization.

- Some airlines are concerned that they would have little or no leverage with a private operator, unlike with public airports where they feel they have more influence.
- However, the airlines see merits in the idea of stable and predictable landing fees and rental rates that could come under privatized airports.

Also, as a result of the concessions made in the proposed Midway transaction, the airlines have started to be more receptive to potential long-term leases. For example, regarding the Midway transaction, Southwest Airlines representatives said:

*“In general, U.S. airlines tend to be wary of privatization because it tends to layer new debt or equity on top of existing airport obligations, thereby generating increased airlines rates. None of us wanted to pay inflated rates and charges. Plus, U.S. airlines have a significant amount of say about how U.S. airports are operated from both an annual budget and capital perspective. The idea of losing that ability gave us hesitation. We had to understand what kind of agreement would make that weighty proposition attractive.”<sup>10</sup>*

*“With the city, Southwest welcomes the opportunity to increase our collective knowledge about airport privatization in a manner that hopefully produces a mutually beneficial outcome for both the city and the airlines.”<sup>11</sup>*

*“We are very interested in finding solutions to the airport cost problem, and to the extent that privatization is a workable tool, we will be interested.”<sup>12</sup>*

*“Privatization was a potential way for Southwest Airlines and other carriers to get a more predictable (and lower especially in the near term) rate structure made possible by the agreement we negotiated.”*

It was important to Southwest Airlines that the Midway deal included price caps and operating standards. The operator lease included extensive performance standards that were negotiated with the city and Southwest. Southwest also required guarantees that the airport will be run in a customer-service friendly fashion, with a particular focus on pricing controls – to the greatest extent possible – with respect to parking, concessions, etc. Southwest wanted to make sure that concessions and parking rates, in particular, were competitive with those at Chicago O’Hare so that use of Midway by passengers was not cost-prohibitive.

The Midway lease also required that the operator continue to make capital expenditures to maintain and develop the airport, which was an important factor for the airlines.

Another airline representative commented about Midway:

*“Midway clearly pointed out that it is possible to construct a contract that has benefits to the airlines and greater cost certainty, which make it attractive. If the third party had been able to deliver the things promised at Midway, we would be supportive.”*

However, there was still skepticism whether the operator could have made the Midway deal work and concern that the deal might have been renegotiated if the operator was failing. One airline

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<sup>10</sup> Amy Weaver, *Southwest Airlines says Midway indicates privatization can fly in the United States*, HNTB Aviation Insight, Spring 2010.

<sup>11</sup> Yvette Shields, Chicago, *Southwest Reach Preliminary Lease Understanding*, The Bond Buyer, November 16, 2007.

<sup>12</sup> Yvette Shields, *Airports Poised for Privatization, Midway Seeks Lease; Others Could Follow*, June 18, 2008.

wondered if the bidder saw Midway as a “loss leader” which would imply a similar deal could not be replicated.

***Partial Privatization Models.*** Regarding partial privatization schemes, the airlines commented:

- Airline special facility financing of unit terminals is likely to have limited application in the future because the rules have changed (since recent airline bankruptcies) and access to capital is more difficult and costly. Some deals are getting down, but they do not have the same economics as they once had. Moreover, there is less certainty now when a deal is started that the financing will be available and affordable.
- Regarding the Indianapolis management contract, the airlines felt that while there were benefits at the front end of the contract, at end both the airport and airlines were questioning the significant payments with no additional benefits.
- Airlines have embraced the concept of the airline terminal equipment maintenance consortium, which have evolved since the first application at Chicago O’Hare’s Terminal 5 and includes those at Detroit and Midway most recently, as a means of achieving cost savings. These are limited to equipment used by the airlines and transfer the functions performed by the public operator to a private entity to manage and maintain the equipment more efficiently.

One recent example of a successful private terminal development is the \$519 million a new passenger terminal project at Dallas Love Field that is being managed by Southwest Airlines. According to a Southwest Airlines executive, the project is ahead of its original construction schedule and is likely to finish below budget:<sup>13</sup>

*"We have tried to build this project for speed. We think it's been a very, very successful project, and we think we've been able to deliver it at 25 percent less cost than what the public sector would have done."*

Under the old schedule, the new passenger terminal was expected to be complete in the fall of 2014 with the baggage handling project coming a year later. Under Southwest’s schedule, the full project is expected to be complete by the fall of 2014 when the Wright amendment is fully repealed.<sup>14</sup> The improvements are being financed by a partnership between the city and Southwest. Southwest entered into a special facilities agreement with the city of Dallas and the conduit issuer of the tax-exempt bonds, the Love Field Modernization Corp. Southwest is responsible for repaying the debt, therefore, the bonds carry the airline’s rating of BBB from Standard & Poor’s with a negative outlook and Baa3 from Moody’s Investors Service with a stable outlook.

## **G.7 USDOT/FAA**

The USDOT and FAA are responsible to implement federal laws and programs as well as monitor compliance with these laws. Federal rules and policies on privatization are somewhat ambiguous,

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<sup>13</sup> Eric Torbenson, *Love Field renovation under budget and early, exec says*, The Dallas Morning News, December 15, 2010.

<sup>14</sup> The Wright Amendment was passed by Congress in 1979 to protect the Dallas-Fort Worth International Airport that opened in 1974 from competition from Love Field. Under the Wright amendment, passengers must change planes in another airport in Texas or nearby states to fly to long-haul destinations (except for aircraft with 56 or fewer seats that can fly anywhere in the U.S. from Love Field). A bill that repeals the Wright Amendment was passed by Congress in September 2006, which allows airlines to operate nonstop service from Dallas Love Field to long-haul destinations starting in 2014.

which causes uncertainty for local governments wanting to consider privatization opportunities. As noted in other chapters, the biggest disincentives to privatization in the U.S. include:

- Access to tax-exempt debt for public airport owners
- Access to federal grants for public airport owners
- The prohibition on diverting airport revenue
- The potential requirement to repay federal grants
- Limitations on aeronautical charges

***Tax-exempt Debt.*** The November 2010 report by the National Commission on Fiscal Responsibility and Reform (“Deficit Commission”) seeks to revoke the tax-exempt status of state and municipal bonds. This move would significantly raise the cost of borrowing money for local governments, including public airports. On the other hand, in its December 2010 report, the U.S. Department of Transportation’s Future of Aviation Advisory Committee (“FAAC”) recommended extending the AMT tax holiday for airports for four more years.

“The FAAC recommends that the Secretary should support federal legislation to provide a four year extension to the Alternative Minimum Tax (AMT) exemption for airport Private Activity Bonds...U.S. commercial airports are mainly owned and operated by government entities and airport improvements are often multi-year projects, providing numerous construction jobs helping to stimulate the community. This exemption lowers airport financing costs allowing for more development or reduced debt.”<sup>15</sup>

As described in a 1996 GAO report, the effects of privatization on the federal government depend on whether privately owned airports continue to be denied tax-exempt status.<sup>16</sup> The report noted that although access to tax-exempt debt significantly reduces financing costs for public airports, it substantially reduces the federal government's revenue.

***Availability of Federal Grants.*** The GAO report also commented that the effects of privatization on the federal government depend on whether privately owned airports will have access to federal grants. The report also reasoned that if privately owned airports were not eligible for AIP grants and if a significant number of airports were privatized, 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. Indeed, the Deficit Commission also suggested eliminating grants to large and medium-sized hub airports. Under the previous administration, the FAA recommended reducing apportionment grants for large and medium-sized hub airports.

***Revenue Diversion.*** The GAO report noted that the FAA generally discourages full privatization (i.e., long-term lease or sale). Indeed, the lack of certainty under the federal rules for full privatization is in itself a deterrent to airport privatization:

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<sup>15</sup> U.S. Department of Transportation Future of Aviation Advisory Committee, *Recommendations*, December 15, 2010.

<sup>16</sup> U.S. Government Accounting Office, *Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports*, Report to the Subcommittee on Aviation, Committee on Transportation and Infrastructure, House of Representatives, GAO/RCED-97-3, November 1996.

*“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...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.”<sup>17</sup>*

The revenue-use policy is quite restrictive in terms of financial returns to a private operator and limits the upside potential of the transaction. The private operator is permitted to be paid reasonable compensation for providing airport management services and a reasonable return on capital investment under a long-term lease or sale. Regarding the return on investment, the policy says:<sup>18</sup>

*“The FAA expects private owners to be subject to the same requirements governing...the recovery of unreimbursed capital contributions and operating expenses from airport revenue as public sponsors. Under section 47107(l)(5), private sponsors—like public sponsors—may recover their original investment within the six-year statute of limitation. In addition, they are entitled to claim interest from the date the FAA determines that the sponsor is entitled to reimbursement under section 47107(p). Any other profits generated by a privately-owned airport subject to section 47133 (after compensating the owner for reasonable costs of providing management services) must be applied to the capital and operating costs of the airport.”*

**Repayment of Federal Grants.** The Secretary of Transportation has the authority to exempt the public airport owner from any legal requirement to repay prior federal grants. While in the Stewart transaction, the state of New York was exempted from the repayment of federal grants under the current environment of federal deficits and heightened Congressional attention, there could be increased scrutiny of any future transaction. The importance of the Transportation Secretary's discretion regarding the finding on federal grant repayment is likely to be less of a factor for large airports than smaller ones, but nonetheless will impact the valuation of the deal.

**Limitations on Aeronautical Charges.** Airports that have accepted federal grants must comply with certain conditions, including grant assurance 22 that requires the airport sponsor (public or private) to make the airport available for public use on reasonable terms and without unjust discrimination. According to the FAA, this binds both public and private operators to its rates and charges policy. In addition, under the APPP, rates and charges on air carriers cannot increase faster than the rate of inflation unless a greater increase is approved by at least 65% of the air carriers serving the airport and by air carriers accounting for at least 65% of aircraft landed weight at the airport. Unlike the regulatory regimes in some other countries that tend to be more prescriptive, the practice in the U.S. is to let the airports and the airlines reach an agreement at the local level as long as it is not illegal. In the absence of an airline agreement, the airport operator can set rates in accordance with the rates and charges policy where the operator is entitled to recover its operating

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<sup>17</sup> Ibid.

<sup>18</sup> *Policy and Procedures Concerning the Use of Airport Revenue; Notice*, USDOT, FAA, February 16, 1999.

expenses and capital costs (including imputed interest) for aeronautical facilities from the airlines but is under no obligation to share non-aeronautical revenues with the airlines.

In addition, in the case of public-use airports that have not accepted federal grants (e.g., Branson), airlines are not permitted to separately list an airport-assessed facility charge from its advertized fares (e.g., a PFC) because the fee was imposed by a private company not a governmental entity.

***Uncertainties.*** In sum, the uncertainties regarding federal regulations include:

- The continued availability of federal tax exemption for airport debt issued by government.
- The continued availability of federal grants and the associated levels.
- Conditions under which the FAA will approve a sale or long-term lease (pursuant to Grant Assurance 5 that requires FAA approval). The FAA would assess the financial and management capability of the private operator to take on the responsibility of running the airport. The airport operator remains subject to all grant assurances.
- Whether or not past federal grants will have to be repaid, which is potentially an area that could receive more scrutiny by Congress given the federal deficit environment. The airport owner must request the exemption and provide an adequate justification. The Department of Transportation then issues a finding, subject to the Administrative Procedures Act, that explains the decision of the Secretary. If a repayment is required, the amount of the repayment (i.e., the basis upon which it is determined) is unclear.
- Whether or not a private operator can earn a profit from the operation of the airport, and if so, the limits (if any) to that profit. In other words, airports that have received federal assistance after October 1, 1996, are subject to the revenue-use requirement, which applies indefinitely. It appears that the FAA will permit a reasonable return on investment, but there are no parameters nor are there data points to determine how that would be applied.

Because there has only been one airport privatized under the APPP and because there are so few other points of reference for long-term leases outside the APPP, the rules remain uncertain and will be decided on a case-by-case basis.

Moreover, as indicated by the different views taken by the Deficit Commission and the FAAC, there will continue to be uncertainty regarding future federal policy with the contending ideological splits ranging from an extension of the AMT holiday (represented by the FAAC), to deficit reduction (represented by the Deficit Commission), to privatization supporters (represented by more conservative members of Congress).

## **G.8 Private Airport Operators**

A summary of feedback received from private airport operators is as follows:

### ***Limitations of Public Authorities:***

- Public ownership imposes significant costs on the system especially regarding procurement rules (e.g., local business enterprise goals, consultant selection, concession awards). This is both because boards and politicians influence decisions and because their procedures require extra time and expense. Architect and engineering selection, in particular, takes far too long.
- Airport managers who believe their operations could not be more efficient if handled by private operators do not have a good idea about how the politics influences almost

everything at the airport—from procurement, to staffing levels to building unnecessary facilities. There is a belief that there would be enough money to make a decent profit and operate the airport more efficiently at municipal airports.

- Public enterprise is more rigid and cannot adapt to changes as well as private enterprise, and as a result the public does not get the full value from its infrastructure assets.

### ***Operator's Strategy***

- Several operators said their strategy is to stay in for the long haul. While operational expenses are important, the two biggest factors are cost of capital and capital expenditures.
- The areas with most potential for private operators are (1) operating efficiencies, including maximizing the utilization of existing facilities, (2) maximizing non-aeronautical revenues, and (3) financial engineering.
- With regard to maximizing the utilization of existing facilities, one operator commented that they have seen 30% to 40% savings in terminal space requirements by strategically positioning new technology such common use self service kiosks at key points (parking lots, rental car return areas) to move passengers more efficiently and minimize the amount of ticket queue space needed. Also, private entities can move faster than the public tender process for procuring concessions and in capital development.
- In terms of non-aeronautical revenues, by making the security screening process more efficient, passengers have more time to spend post security and are more relaxed. In addition, private operators tailor concession programs to the airport's demographics and actively manage these programs.
- Although private operators can optimize the capital structure in a prudent manner, they universally agree the savings from tax-exempt financing outweighs the depreciation available under traditional financings (bank financing and equity capital). Tax-exempt financing is roughly one-third cheaper. Bank financing is tied to LIBOR + margin and the margin can vary significantly by market. For example, in Midway when the financial markets fell away after the bid, there was no bank financing available to put the financing together. Pension funds and infrastructure funds are direct equity investors. But operators still need access to debt capital for an efficient structure, which is typically bank debt or capital market (not tax-exempt). Moreover, bank loans have shorter amortizations, which increase the refinancing risk.
- The tax-favored status in the US (which was cited as worth as much or more than 200 basis points) is a significant deterrent to full privatization. With capital expenditures it is vital to time it correctly and not overbuild.
- At least one operator mentioned they do not pursue a “cash flow” strategy like other operators or strategies focusing on serial refinancing of loans. Some expressed a belief that privatization operators should have “skin in the game.”

### ***Myths About Private Operation:***

- Operators were dismissive of those who cite privatization as likely to lead to increased costs to air carriers. It is in the interest of the airline and the private operator to keep costs low. Also, governments retain economic regulatory control over rates.

- Operators were also dismissive of claims that they cannot make up for the money they take as profit by reducing costs on the airport. The biggest savings they see is with procurement and management obligations of the public sector. Part of those savings can be used to hire more qualified staff, even if they have to pay staff more to operate airports. The operators invest in good people and use their expertise to drive down the costs of operating the airport and keeping capital expenditures in check.
- Regarding consumer concerns about increased parking rates and concession pricing, one operator commented that this is a fallacy. At the end of the day, the private operator needs to be competitive with off-airport parking lots and other modes of transportation. Through better management, prices don't have to be higher to achieve more net revenue.
- Regarding the theory by some that gains in the early years of private operation reach diminishing returns in later year, one operator disagreed. He said every year management must get more efficient and find more sources of revenue.

### ***Labor***

- Private operators have more flexibility to incentivize employees (e.g., bonuses, succession programs, and training), can use employees for a wider range of disciplines, and are not burdened by public processes.
- In the case of Midway, (1) the operator was required to accept the existing collective bargaining agreements, (2) the operator had to recognize the unions throughout the lease term, but could renegotiate the terms of the agreements once they expired, (3) the operator had to offer every employee a job at their existing wage and benefit level although pension benefits did not transfer over -- employees would switch to a new pension program, and (4) employees had the choice to accept the job offer or could work elsewhere in the city government. The vast majority of the employees accepted the employment letters from the operator, which the city was pleased and surprised to see. The employees were motivated by the opportunity to work for a private operator with no change in pay/benefits plus incentive compensation and career development opportunities working for a company with a global network.

### ***Airline Ownership***

- Airlines should definitely not be part of the ownership group.

### ***Airport Privatization Pilot Program***

Several private operators expressed doubts and concerns about the APPP, in particular:

- The APPP is an “utter failure.”
- Some operators commented that Midway is the “wrong example” for privatization because there is no upside and it is an “awful template” for the U.S. privatization effort. In particular, they did not see adequate opportunities in Midway because (1) the airport was built out and the associated Illinois legislation prohibited any expansion of Midway's boundaries, (2) the airport was not poorly managed, and (3) the non-negotiable airline agreement was unduly restrictive. In fact, some commented that unfortunately, the airlines are viewing Midway as a model and the APPP is fundamentally flawed because of it. For example, one operator commented:



*“The allure to privatizing an airport is when it can grow, and grow a community's revenues along with it. Midway is not one of those airports and is the wrong example. However, Branson, Mo., which is selling naming rights to the new airport and is in total control of the ground-handling and the FBO, for example, has more latitude to make it a financial success.”<sup>19</sup>*

- The U.S. regime provides significant benefit to government ownership. Unless the rules change, there is no hope for full privatization of airports in the U.S.
- The unusually restrictive rules under the APPP give airlines an “effective veto” over privatization.

#### **Potential for Privatization in the U.S.:**

- The Federal government cannot be a bottomless pit for funding infrastructure, especially with all the social funding needs.
- Why should the federal government “subsidize” airport capital through tax-exempt financing?
- A uniform PFC is “dumb” because not all airports have the same capital needs.
- The only privatization potential in US is for specific facilities (e.g., terminals, central receiving, cargo, etc.), not the whole airport.
- However, the selected bidder for Midway (MidCo)<sup>20</sup> said in a press release after its selection it: *“was attracted to this opportunity given the existing world class airport facilities and the ability to work with the airlines serving the airport, the city of Chicago, and the employees at Midway Airport. We believe together, in this partnership, we can build on the success and reputation of the airport.”<sup>21</sup>*

#### **Regulation**

- The operators highly recommend generic legislation that is subject to a transparent process. Predictive regulation is bad. Regulation should be tailored around individual assets in each community so they can define the specific goals and objectives.
- The operators prefer light-handed regimes with no pricing regulation, because it provides the most flexibility. This is where they can derive the most value and benefit. They do not mind being monitored under light-handed regimes for level of service.
- Some operators shy away from structures that limit flexibility such as heavy-handed regimes.

#### **Benefits of Privatization**

One operator commented that “privatization is a win-win-win proposition”:

- Municipalities can preserve their balance sheet and focus on public service needs and funding pensions and budgets.

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<sup>19</sup> Comments from Charles Stipancic, president and CEO of Aviation Facilities Company Inc. in Jennifer Michels, *Midway Focus In Airport Privatization Debate*, Aviation Week, March 26, 2009.

<sup>20</sup> The consortium, known as Midway Investment and Development Co., comprises YVR Airport Services Ltd. of Vancouver, Citi Infrastructure Investors of New York, and John Hancock Life Insurance Co. of Boston.

<sup>21</sup> Yvette Shields, *Chicago Eyes Lease For Midway, Privatization Would Bring in \$2.5 Billion*, The Bond Buyer, October 1, 2008.

- Airline can achieve more efficient operations, more transparent and lower rates and charges (by operators increasing non-aero revenues), and decreased capital expenditures.
- Passengers benefit from more efficient and better facilities, more choice, and more non-aeronautical options.

## **G.9 Financial Institutions**

Financial institutions have played an important part in airport privatization in the U.S. and worldwide. In any privatization transaction, it is likely that financial institutions will be involved in one or more of the following roles:

- Advisor to the government
- Advisor to the potential buyers
- Investor in the equity of the airport, either directly or in a fund management role
- Provider of acquisition debt financing
- Ongoing lender to the airport.

This section focuses on those financial institutions with a financial interest in airport privatizations, rather than those acting as advisor. A distinction is made between financial investors providing equity and lenders (i.e. those involved in the provision of debt financing).

The information contained in this section comes from interviews with stakeholders, as well as from the research team's extensive experience of interacting with financial institutions in the context of airport privatizations.

### **G.9.1 Lenders**

Lending institutions are often intimately involved in airport privatizations, either as providers of debt financing to support the acquisition, or as ongoing lenders to the airport. Over the past ten years or so, there has been a shift in the role which lenders play in airport financing. The arrival of infrastructure funds in particular has led to airports increasingly being viewed as stable cash-flow generating entities capable of sustaining higher levels of debt financing.

In addition to lending banks, airport investors or airports can secure debt financing from the bond market. Many airports are financed by a mix of equity, bank debt, and bond debt. Rating agencies often play an important role in the debt financing of airports. Organizations such as Moody's, Standard & Poor's and Fitch assess the creditworthiness of an airport, and assign a rating accordingly. If the rating agency issues a 'strong' rating, the debt will be cheaper, i.e. available at a lower margin, than if a 'weaker' rating is issued. Generally, airports aim for an investment grade rating (e.g. BBB- or higher for Standard & Poor's).

Before the start of the financial and industry downturn in 2008, airport privatizations raised significant proceeds, as infrastructure funds and other airport investors competed for available investments and were willing to offer purchase prices at significant multiples of EBITDA. Debt financing played an important role in this 'airport bubble' as banks became increasingly comfortable with high levels of leverage for airports.

This situation has changed somewhat since 2008, partly as a result of the financial downturn. A number of highly leveraged acquisitions required refinancing and in some cases airport owners

found it difficult to attract new lenders to an investment which, as a result of the decrease in air traffic, was viewed as relatively high risk. Moreover, a more challenging regulatory framework was being developed for banks, leading to lenders being more cautious generally. Rating agencies also have a role to play, and in the period from 2007 to 2010, the ratings of a number of airports were downgraded, in some cases even twice within a three year period.

In this more challenging financial climate, lenders can be more selective when it comes to identifying investment opportunities, particularly given the large number of airport refinancings expected to be required from 2012 onwards. Airports or airport investors seeking debt financing will have to fulfill a number of lenders' requirements, which are likely to focus on the following areas:

- Leverage, seniority, and refinancing risk
- Cash flow stability
- Security

### **Leverage, seniority and refinancing risk**

Similar to the financial investors in airport equity, discussed above, lenders are principally concerned with being appropriately rewarded (via an interest rate margin) for the risk they are exposed to as a result of providing debt financing.

A key concern specific to lenders is leverage, i.e. proportion of the airport's enterprise value (as expressed through the purchase price in the case of an acquisition) funded by debt rather than equity. From a lender's perspective, risk is increased when leverage is higher: A higher proportion of debt means larger cash flows are needed to meet the debt service obligations, which must be satisfied to avoid the airport defaulting. Conversely, if an airport is mainly equity-funded, a larger proportion of the cash flows generated will be used to pay dividends, which are discretionary and only paid once the debt service obligations have been met in their entirety. For an airport or airport investor, a key challenge is the balancing of the increased risk (and therefore increased interest rate margins) associated with high leverage with the lower overall cost of debt compared with equity. Higher leverage often results in higher returns on equity, but only if lenders are comfortable taking the associated debt risk.

Similarly, the risk to lenders is impacted by the seniority of the debt, and by the refinancing risk. In the case of seniority, if an airport has existing debt which will rank as senior (i.e. higher in priority in terms of claims on available funds) to the additional debt being taken on, the lenders of this additional debt are likely to be concerned as they will only receive their debt service payments once the senior debt obligations have been met. For this reason, junior debt typically carries higher interest rates to reflect the increased risk. In terms of refinancing risk, if the loan provided is of a short maturity, lenders are likely to be interested in the airport's plans and ability to refinance the loan prior to or at maturity.

### **Cash flow stability**

More than equity investors, providers of debt financing are interested in the stability of the cash flows generated by an airport. A year of poor financial performance is a serious issue from the perspective of a lender, even if it is followed by a year of outstanding financial performance. Lenders need to receive debt service payments each year, unlike equity investors whose dividend payments are discretionary and who benefit from outperformance in a way that lenders do not.

In the context of airports, this means that lenders are likely to be attracted to investment opportunities where fluctuations in cash flows are unlikely. For example:

- Lenders are likely to be more attracted to airports which have limited exposure to traffic risk. This is the case, for example, at airports where charges are revised upwards if traffic is lower than expected.
- Lenders are likely to regard a well-established regulatory regime as a positive factor. In fact, provided the regulatory regime is clear and favorable, regulated airports can represent a more attractive proposition than unregulated airports, which have more upside potential but also more downside risk.

*“The regulatory regime is of key importance. [...] Dual till regulation is generally preferred. It should be possible for the airport to retain at least some of the benefits of efficiency savings made during a regulatory period, otherwise there are no incentives. The length of the regulatory period is important: longer regulatory periods add stability and provide a mechanism for airports to benefit from efficiency improvements during the period.”* **Lender representative**

- Recently built airports with excess capacity are preferred by lenders, as there is risk associated with substantial capital expenditure programs. Budget overruns could have a negative impact on available cash flows, as could failure to complete required facilities on time.

## Security

Another factor of great importance to lenders and of relevance to the interest rate margins they charge is the security available to lenders. In the case of default, lenders need recourse to assets to offset the debt which cannot be paid. For this reason, lenders favor full over partial privatization:

*“Partial privatization (i.e. privatization of part of the airport, such as a terminal) is not as attractive to lenders as full privatization. The security available to lenders in the case of partial privatization is not as strong, particularly as conflicts could arise between the owners of different parts of the airport infrastructure.”* **Lender representative**

This also means that often, lenders prefer providing financing to airport owners who hold the freehold to the airport land and buildings. However, this is not always the case:

*“Although freehold ownership of an airport is attractive from a security point of view, lenders sometimes prefer concessions. There are several reasons for this:*

- *A concession often has a termination value, which can be realized in the case of either the airport operator or the Government failing to meet obligations.*
- *A concession offers more flexibility to lenders, and a greater likelihood of being able to step in and remove the airport operator should things go wrong.*
- *Finally, concessions based on a revenue / profit share agreement effectively provide a financial buffer in scenarios where the Government is willing to forgo the concession payments under adverse conditions.”* **Lender representative**

In many cases, selling the freehold is not possible, as for reasons discussed above Governments are often keen to retain a degree of control over the airport assets, and therefore privatize by means of a

concession or lease. In those scenarios, alternative solutions need to be found to the asset recourse issue and depending on the specific terms of the concession lenders are often able to take comfort from the concession documentation.

It is interesting to note in this context that lenders will take a great deal of interest in the definition of ‘default’ in the debt documentation. In many cases, default is not triggered by a failure to make the debt service payments, but instead is triggered earlier, when certain ratios agreed between borrower and lender are breached. It is also common to include in the debt documentation a stage prior to default, sometimes known as ‘lock-up’. When ratios fall to a certain level, the airport operating company can make no dividend distributions until ratios improve (i.e. all cash is ‘locked up’ in the airport company).

### **G.9.2 Investors**

Financial investors providing equity can be divided into three main categories:

- Private equity funds
- Infrastructure funds
- Pension funds

There are other financial institutions which may invest in airports from time to time, particularly on a short-term basis. These include hedge funds and investment banks. However, medium- or long-term investment in substantial airport stakes are generally made by one of the three categories of financial investor noted above.

Each financial investor will have its own interests and concerns with regard to airport privatization, but there are some concerns that are common to all -- risk and return, control, and transaction process.

#### **Risk and Return**

First, there is the balance between risk and return. Any financial institution contemplating investment in an airport privatization will conduct a detailed review of the risks of the potential investment. This assessment will include risks associated with the asset itself, such as traffic risk, or likely investment required in airport facilities. However, financial investors will also be interested in political and regulatory risk. In this context, investors will be interested to examine which public organizations have the power to significantly impact an airport’s revenues and costs, and will be eager to understand how independent these organizations are from local or national government.

*“The fact that the sale was completed successfully may in part reflect the comfort that potential buyers were able to gain from the regulatory regime.” **Financial investor representative***

The attitude of financial investors providing equity to airports regarding risk can be summarized generally in the table of investment criteria below.

Investment criteria	Risk implication
Infrastructure of major national or regional importance	Lowers traffic risk
Stable government and investment climate	Lowers sovereign risk
Transparent regulatory environment	Lowers regulatory risk
Strong stable and predictable cash flows	Lowers financial risk
Representation on Board and strategic working groups	Lowers operational risk (and increases upside potential)
Influence on operating, commercial, financial and strategic decision-making	Lowers operational, financial risk (and increases upside potential)
Potential to enhance and optimize operational and financial performance	Increases upside potential

Once an assessment has been made of the risk associated with the investment, financial institutions will determine the rate of return that they will require in exchange for exposure to these risks. Clearly, airports which are assessed as high-risk will result in a demand for a higher return from investors. This position is exacerbated by the fact that high-risk airports are unlikely to be able to sustain high levels of debt, thus generating a need for a higher proportion of equity investment.

The required return is likely to vary between the three categories of financial investors identified.

- **Private equity funds** often have a short- or medium-term investment strategy, and plan to sell the airport within 5-10 years of the original purchase. They are likely to have higher return requirements, which they often aim to realize via significant efficiency improvement followed by a secondary sale or IPO at a price substantially above the initial purchase price.
- **Infrastructure funds** tend to plan to invest in airports for a longer period, as much of their capital is sourced from pension funds which value long-term stability over short-term high returns. Nevertheless, the return earned also needs to be sufficient to fund the administrative and management cost associated with the infrastructure fund's involvement. In many cases, the infrastructure fund works closely with airport management to ensure the required improvements in revenues and costs are realized.
- It is becoming increasingly common for **pension funds** and similar institutions to invest in airports without the involvement of an infrastructure funds. For these funds, the return requirements are likely to be somewhat lower since there are no intermediary costs to be funded. However, by investing directly, pension funds lose the ability to spread risk across a portfolio of airports that can be achieved through investment in an infrastructure fund. Direct investment also needs appropriate in-house management skills. The greater the degree of risk involved, the greater the degree to which such management skills are likely to be required in order to maintain investor value. Pension funds are therefore likely to strongly prefer investments that can be regarded as very safe and low-risk.

## Control

The amount of control that is available as part of an airport privatization is important to all financial investors. This relates in part to the interest for sale (minority vs. majority stake) but also to nature of the transaction (management contract, concession/lease or freehold).

Many financial investors have a preference for majority stakes (ideally freeholds) either on their own or with similar like-minded partners, with whom they are confident that they can work. In this context, it has frequently been noted that a trade sale of a majority is generally valued at a significantly higher multiple of profits than has been achieved in, for example, IPOs or sales of minority stakes.

The causes that have been cited for this include:

- Greater degree of scrutiny and challenge of management and their decisions
- Ability to determine and implement aggressive business plan for the company. Financial investors often engage in-house airport expertise or external new hires to implement a new strategy for the privatized airport. The purchase price they offered is likely to have been based in part on forecast traffic growth, efficiency improvements or commercial revenue initiatives
- Majority ownership minimizes the risk that other shareholders, for example the Government with a remaining shareholding, will take the airport in a direction not deemed desirable by the financial investor
- Scope to secure leading-edge financing with relatively high levels of debt (an approach which has led to some significant challenges in the wake of the debt crisis). The techniques used are often dependent on the investor holding a majority stake, or on ownership of the freehold.

However, it is accepted by financial investors that the government often deems it desirable to retain a degree of control over facilities that are regarded as important national assets. Concessions are often used as a structure to achieve this objective, and financial investors are familiar with them and are generally comfortable, provided the lease is sufficiently long (one investor suggested a length of 40 years as a minimum). In weighing up the overall investment proposition, many financial investors tend to attach greater importance to the proportion of shares for sale rather than the concession vs. freehold issues. Management contracts, however, are different, and are unlikely to attract financial investors.

*“[We have] experience with leases of different length, and would suggest that anything under 40 years is problematic as it means that property development at the airport is generally not viable, unless the government becomes involved in agreements to cover the period after the concession ends.”* **Financial investor representative**

An overview of the likely attractiveness of different propositions to financial investors is as follows:

	Management Contract	Concession or Lease	Freehold
Minority interest	x x	✓	✓
Majority interest	x	✓✓	✓✓✓

Of interest, in some cases financial investors regard an ongoing minority interest held by the government as having a positive impact on the investment proposition. It can be a way of ensuring that the government’s and the investor’s objectives are aligned, which is seen as valuable particularly in regions with higher sovereign risk. On the other hand, selling 100% of the interest has the advantage of removing any conflicts of interest.

*“The benefit of [privatizing 100%] is that the Government has no conflict of interest: it is not, for example, concerned with environmental matters while also being the airport owner. On the other hand, investors are not ‘protected’ from adverse regulatory decisions in the same way they would be if the Government was a co-shareholder.”* **Financial investor representative**

### Transaction process

As with all other potential buyers involved in airport privatizations, financial investors tend to incur significant costs in relation to their bid. A government seeking to privatize its airport(s) therefore needs to give careful consideration to the design of the privatization transaction process. Failure to meet the requirements of potential investors could lead to a lack of willingness on the part of investors to participate in the bidding process. Based on our experience with financial investors, the following are regarded as key success factors:

- **Transparency:** It is important to financial investors that the transaction process is transparent. This applies particularly to the government’s privatization objectives, and to the criteria which the government will use to choose the winning bidder. Financial investors value it if these are stated explicitly, so they can tailor their offer and improve their chance of being successful.
- **Clear timetable:** There are many examples globally of privatizations which have been delayed for lengthy periods of time, or even indefinitely. Delays damage the ability of the private operator to attract financial investors because a clear and credible timetable is of crucial importance to secure their interest. While timetables should not be unrealistically demanding, financial investors have a general preference for a compact timeframe, reducing the period of uncertainty and the cost incurred for bid preparation.
- **Optimal provision of information:** Financial investors are likely to employ teams of experts in the relevant areas (e.g. traffic, business planning, legal and accounting advisers). These experts are familiar with airport transactions, and will require access to a substantial amount of information in order to conduct an appropriate level of due diligence. Financial investors generally value this information being made available online via an electronic dataroom. A question and answer process involving the airport’s management team is also regarded as important. To avoid overwhelming investors with information, a clear and concise information memorandum should be produced, and documentation in the dataroom should be clearly labeled.

*“[The transaction] was very well run: a clear timetable was set out for bidders and there was no uncertainty about the process itself. An electronic dataroom was used, which was very helpful.”* **Financial investor representative**

- **Access to management team:** As discussed above, many financial investors will have a strategy for the airport which involves making a number of operational improvements. Although they may be planning to use experts external to the airport management team to achieve this, they are likely to be very interested in the quality of management already available at the airport. Access to the management team through, for example, a management meeting and a site tour, is regarded as important.



In addition to the above, financial investors are also interested in the cost of transactions relative to the likelihood of success. One aspect of this is the number of competing bidders participating in the process. Clearly, a large number of bidders generally means a smaller likelihood of winning, while the cost of participating in the bid remains the same. Although it is not necessarily in the government's power or indeed interest to limit the number of bidders participating in a privatization, this issue can be overcome by designing a process with two or three stages. The first stage should be designed in a manner that minimizes the cost of participating, for example through providing a clear and concise information memorandum, enabling a large number of bidders to participate. By means of indicative bids and business plans, the seriousness of bidders can be assessed. In the second round, selected bidders are more likely to be willing to incur the significant expenditure associated with conducting due diligence and arranging financing, particularly if they know the number of competing bidders is more limited at that stage. Costs can also be reduced by vendor due diligence where initial work on business planning, asset condition, and accounting and legal reports has already been done for bidders, giving them the challenge to develop this further rather than start from the beginning.

In contrast to processes which minimize cost, approaches which require all bidders to undertake substantial upfront expenditure, especially those requiring an expensive and detailed design/planning competition at the outset, are likely to be far less attractive to bidders.

### **G.9.3 Financial and Legal Advisors**

A key task for financial and legal advisers is to explain to the government which risks can be passed to the private investors and which cannot, or at least not at a reasonable price. They must also explain the tradeoffs that are inherent in putting together bankable transactions, which have become more challenging since the recent financial and economic crisis. In addition, they must develop a reasonable estimate of the value of the transaction based on the specific fact case and must carefully manage the government's expectations regarding the value of the sale or lease.

Some financial and legal advisers believed the Midway transaction would serve as a model for future airport leases in the U.S. and could set the stage for an expansion of the federal pilot program. These advisers also thought Midway would trigger national interest from cities that own and operate airports because of the financial incentives, and would trigger interest from airlines wanting to control future airport operating costs. However, the size of the Midway bid (\$2.5 billion) raised the bar for all future proposals in the U.S. Ultimately, the Midway bid was not financeable with some participants blaming the credit crunch and other parties citing the unrealistic bid amount.

### **G.10 Rating Agencies**

The rating agencies evaluate the likelihood of debt repayment and the capacity and willingness of the debtor to meet its financial commitment in accordance with the terms of the debt obligations. Each of the three primary rating agencies has published criteria regarding their approach to rating privatized airports:

- Moody's issued detailed guidance setting out their approach to rating airport companies and other entities issuing debt for airports outside the U.S.<sup>22</sup> (Moody's rates U.S. airports

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<sup>22</sup> Operational Airports outside of the United States, Moody's, May 2008.

under a separate rating methodology given their governance structure and because they are rated according to Moody’s municipal rating scale.)

- Fitch issued a comprehensive rating criteria report that is applicable to U.S. and non-U.S. airports, but includes criteria and metrics specific to non-U.S. airport credits as well as rating criteria for infrastructure and project finance.<sup>23</sup>
- Standard & Poor's issued guidance on its analytical approach to rating U.S. airport concessions.<sup>24</sup>

In general, the rating agencies would view privatized airports in the U.S. similar to airport concessions they have evaluated internationally given the limitations on aeronautical rate increases and higher dependence on non-aeronautical revenue growth. The primary credit objective is to have debt fully repaid by end of the concession with an appropriate “tail period” (i.e., the period between debt maturity and end of the project life or concession end date). Nevertheless, each credit would be viewed in the context of the specific market and legal structure.

S&P’s analytical construct for privatized airports is shown in Table G.2.

**Table G.2. S&P’s Analytical Construct for Privatized Airports**

<b>Business Risk Profile</b>
<ul style="list-style-type: none"> <li>▪ Airline industry and airport-sector risk analysis</li> <li>▪ Competitive position of the concession, peer, and catchment area analysis</li> <li>▪ Cash flow protection, business plan analysis, and profitability</li> <li>▪ Traffic demand, including characteristics of regional air service area economy</li> <li>▪ Local airline market analysis, including airline diversity, markets served, passenger mix, historical and forecast aeronautical activity</li> <li>▪ Government policy and regulation</li> <li>▪ Operational analysis and capital investment plans, including an analysis of the quality and complexity of the assets</li> </ul>
<b>Financial Risk Profile</b>
<ul style="list-style-type: none"> <li>▪ Financial policy, cash flow adequacy, and debt guidelines</li> <li>▪ Liquidity and financial flexibility</li> <li>▪ Concessionaire operator experience and management practices</li> <li>▪ The risk appetite of management and shareholders and the likelihood of new acquisitions and/or speculative property development</li> <li>▪ Revenue diversity and stability</li> <li>▪ Legal and concession agreement analysis;</li> <li>▪ Capital structure, debt maturities, liability management</li> <li>▪ Dividend policy and history of significant or special shareholder distributions during different economic cycles</li> </ul>

<sup>23</sup> Rating Criteria for Airports, Fitch Ratings, November 29, 2010; and Rating Criteria for Infrastructure and Project Finance, Fitch Ratings, August 16, 2010.

<sup>24</sup> Kurt Forsgren and Jodi E Hecht, *Credit FAQ: Evaluating U.S. Airport Concessions*, Standard & Poor’s, September 17, 2008.

Moody’s analytical framework for rating non-U.S. airports includes 6 key factors, 18 sub-factors, and associated weightings for each factor, which is similar to the valuation logic used in rating toll roads due to the similar creditor protection features as summarized in Table G.3:

**Table G.3. Moody’s Analytical Framework for Rating Non-U.S. Airports**

Key Factor	Sub-Factors	Weighting*
1. Governance & Rate Setting	<ul style="list-style-type: none"> <li>▪ Legal Status / Corporate Objectives</li> <li>▪ Rate Setting Methodology</li> <li>▪ Nature of Ownership / Control</li> </ul>	15%
2. Market Position	<ul style="list-style-type: none"> <li>▪ Size of Service Area</li> <li>▪ Robustness &amp; Diversity of Service Area</li> <li>▪ Competition for Medium to Long Distance Travel</li> </ul>	15%
3. Passenger & Airline Base	<ul style="list-style-type: none"> <li>▪ Passenger Mix (O&amp;D / Transfer)</li> <li>▪ Standard Deviation of Long Term Average Annual Passenger Growth Rate</li> <li>▪ Carrier Base (Transfer Traffic)</li> </ul>	10%
4. Stability of Business Model & Financial Structure	<ul style="list-style-type: none"> <li>▪ Ability &amp; Willingness to Pursue Opportunistic Corporate Activity (M&amp;A, Disposals, Investments)</li> <li>▪ Ability &amp; Willingness to Increase Leverage</li> <li>▪ Targeted Proportion of Revenues outside of Owned Direct Airport Services</li> </ul>	10%
5. Operating Environment & Capital Program	<ul style="list-style-type: none"> <li>▪ Operational Restrictions</li> <li>▪ Complexity of Airport Capital Expenditure Program</li> </ul>	10%
6. Key Credit Metrics (Historical & Projected)	<ul style="list-style-type: none"> <li>▪ Cash Interest Coverage</li> <li>▪ Cash Flow From Operations or FFO / Debt</li> <li>▪ Moody’s Debt Service Coverage Ratio</li> <li>▪ Moody’s Concession Life Coverage Ratio</li> </ul>	40%

\* Within each key factor, individual sub-factors count equally.

Moody’s maps all of these factors to the rating grid to produce a score that determines the airport’s credit rating category. However, Moody’s rates publically owned and operated non-U.S. airports different than those that are privately owned or operated in recognition that these airports tend to have more discretion to set aeronautical rates and typically have rate charging covenants. Moody’s considers these airport authorities to have “entrenched creditor rights” (e.g., Canadian airports).

In terms of the primary credit issues for airports that are put out to bid, S&P commented:

- *Unlike traditional corporate structures or public finance models, concession structures that are the product of a public bid process tend to leverage to the highest degree possible to maximize the bid price.*
- *In general, the more aggressive the financial structure, the less robust the business profile, the weaker the legal provisions, and the greater the contractual risk allocation to the operator, in our opinion, the lower the rating on the debt of a concession or infrastructure asset.*
- *Stress tests and sensitivity analyses play a key role in our evaluation, particularly when the financial structure is predicated on significant and sustained revenue growth... Airports and the passenger-derived revenues have been and, in our view, will continue to demonstrate cyclicity and we would expect investment-grade structures to accommodate the down cycles and underperformance relative to equity sponsors' forecasts.*

In terms of credit factors differentiating private airports from publicly operated airports, S&P noted:

- *...publicly owned and operated airports have higher leverage relative to measures such as net operating revenues, due in part to the absence of equity in the capital structure.*
- *Airports operated by corporate entities often have higher risk tolerance on a variety of business practices related to revenue maximization and financial policies related to their capital structure, dividend distribution policies, acceptance of refinancing risk and bullet maturities, and other factors that are reflected in their generally lower ratings.*
- *Profit maximization and meeting shareholder return targets through dividends under a regulated model are primary objectives of the corporate airport company.*
- *Alternatively, the primary objectives of U.S. airports are not centered on profit maximization... Rather, U.S. airports most often have a public benefit mission and align their operational and financial practices to meet the broader policy objectives of the government owner, such as air service development, economic development or public employment.*
- *Key distinctions reflected in our analysis between publicly owned and operated airport enterprises and airport companies include the role of equity and distribution of dividends from cash flow.*

According to Fitch:<sup>25</sup>

*“Private ownership does not by itself preclude medium to high investment-grade ratings. However, the need to optimize equity returns may result in a capital structure that is inconsistent with higher credit quality. Fitch does not view one form of ownership and/or control as stronger than the other but views favorably managers that act in the interests of the airport and its stakeholders.”*

In explaining why non-U.S. airports often carry a lower credit rating, Fitch explains:

*“Most large airports were public authorities that were corporatized (and sometimes privatized). These are now ordinary corporates (not project finance vehicles) without proper ring-fencing and are not purpose-restricted. They can invest in activities more or less distant from their core activities, introducing “business model uncertainty”. Debt is usually at the parent level, together with the concession or license, and is rarely non-recourse. For all these reasons, within the infrastructure and project-finance universe, non-US airports tend to feature weaker attributes on structure and information factors than the average of the portfolio.”*

## **G.11 Labor**

### **G.11.1 UK Experience**

Interestingly, in reaction to the UK Competition Committee’s proposal for BAA Ltd. to sell three of its seven airports in mid 2008, the UK's largest labor union, Unite, said the recommendation threatened jobs and the traveling public. Steve Turner, national secretary of Unite said:<sup>26</sup>

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<sup>25</sup> Fitch Ratings, *Rating Criteria for Airports*, November 29, 2010.

<sup>26</sup> Marietta Cauchi, *Labor Unions Slam BAA Break-Up; Threatens Jobs, Public*, Dow Jones Newswires, August 20, 2008.

*"This union and our members will not sit back while the market plays games with their jobs and their terms and conditions of employment. Any attempt to break up BAA will be resisted."*

### **G.11.2 U.S. Experience**

In the Midway transaction, the city of Chicago secured the support of unions by ensuring in any lease that current employees would be offered jobs with similar pay and benefits. The city's commitment to fund pensions and infrastructure also helped win union support for the transaction.

#### ***Policy Priority***

The Transportation Trades Department ("TTD") is a strong supporter of the transportation industry and an advocate for federal funding of highways, transit, airports, rail and other transportation infrastructure. Their priority is that organized labor be involved in all parts of transportation from design, construction, and maintenance of infrastructure to its operation with unionized employees. According to TTD, privatization is an issue they track closely to ensure the interests of its members are protected. This includes concern that abrogating union contracts, limiting the collective bargaining rights of labor and cutting wages and benefits might become attractive cost-saving strategies for potential private owners of airports. Its mandate, for example, includes ensuring that private operators do not have the motivation to reduce investments in infrastructure and operations which might have an adverse impact on an airport's level of safety.

#### ***Privatization Strategies***

TTD and its member unions represent workers in the public and private sectors and therefore it does not favor one sector over another. They are focused, however, on maintaining and expanding the unionizing and collective bargaining rights of their members. Therefore, any privatization policies that enable either the direct abrogation of union contracts, the contracting out of existing airport employees' work (e.g., firefighting services), or have the clear effect of reducing wages and benefits will be measures they strongly oppose.

APPP: In 1996 during the legislative debate, and afterward through the rulemaking process, TTD lobbied to constrain the APPP by working to limit the number of airports that could apply to participate in the program; by prohibiting the abrogation of labor contracts through the privatization process; and by urging the FAA to institute safety hearings and reporting requirements for airports that successfully completed the APPP application process.

In 1999, in comments to the FAA Docket No. 29088 (*Notice of Receipt of Final Application of Stewart International Airport, Newburgh, New York; Request for Comments*), TTD communicated with FAA Administrator Jane Garvey to urge that the provisions in statute and regulation that protected collective bargaining agreements be fully enforced and that the FAA carefully monitor the level of safety and security, including necessary investments to improve and modernize the airport.

#### ***APPP and Midway***

TTD reports that Chicago labor representatives were very pleased with the labor-related provisions of Request for Qualifications ("RFQ") that the city issued in February 2008 for Midway. Chicago Mayor Richard M. Daley helped to usher through a process that provided labor protections that both met the statutory and regulatory requirements and actually went beyond those requirements to

include several labor-friendly provisions. Among those included in the RFQ (based on State of Illinois Public Law 94-750) are:

- No abrogation of collective bargaining agreements in place at the time of the lease.
- Encouraging project labor agreements for projects with estimated contract values of \$500,000 or more (a PLA allows for the negotiation of a work agreement with unionized construction labor in exchange for mutually binding grievance procedures, guarantees against strikes or lockouts, and a reliable source of skilled and experienced labor).
- Instituting labor neutrality and card check procedures for aviation employees on the leased property. (This provision encourages the lessee to negotiate in good faith to put these procedures in place, which prohibit management from actively opposing unionization and certify a union has been created when a majority of employees have signed cards requesting a union).
- Protecting workers from wage and benefit reductions. Workers who were in bargaining units at the time of the lease must be paid “an amount not less than the economic equivalent of the standard of wages and benefits enjoyed by the lessor’s employees who previously performed that work.”
- Required offers of employment. The lessee must offer employment under substantially similar terms and conditions to employees and the City of Chicago must offer employment in another department, division or unit of the municipality. This provision, in effect, gives employees the real choice to stay at the airport under a new owner or to stay as a public employee in the City.

For organized labor, having Mayor Daley as an ally in the proposed privatization of Midway provided a strong level of reassurance that employees would not be adversely affected. Not surprisingly, in the view of labor interests generally, the Midway privatization proposal could serve as a model for other airport owners to emulate if they pursue the APPP.

## **G.12 Passengers/Community**

Passengers are primarily concerned with the prices and the quality of service. Prices include airline fares, purchases from airport concessions (e.g., food/beverage, merchandise, services), and the cost to use airport facilities such as parking, rental cars, taxis, wifi, etc. For example, if airline costs increase as a result of a change in operation, the airlines could increase their ticket prices and/or cut back or eliminate flights in response.

### **G.12.1 UK Airport Experience**

The UK’s aviation regulator, the Civil Aviation Authority (“CAA”), imposes an incentive plan to encourage airport operators to improve the quality of service for passengers and airlines at London Heathrow, Gatwick, and Stansted airports and to penalize them for poor service. The CAA introduced the service quality schemes at London Heathrow and Gatwick airports in July 2003 and extended them to Stansted in 2008. The standards, which distinguish between services provided to airlines and those provided to passengers, include cleanliness, lifts and escalators, availability of arrivals baggage reclaim carousels, departure lounge seat availability, way-finding, and flight information. Each airport is required to publish its performance on a monthly basis against the specific service standards and must also prominently display this information on signs in the airport.

The CAA standards were strengthened significantly in April 2008 when the CAA introduced new standards, including transfer security queuing at Heathrow. With respect to Heathrow and Gatwick airports, the CAA said:

*"...they have failed to manage security queuing and queue times to avoid unacceptable delays to passengers and flights and consequently have not furthered the reasonable interests of the users of Heathrow and Gatwick. The Commission considers that these effects adverse to the public interest can be remedied or prevented by the extension and strengthening of the existing service quality conditions and/or by the imposition of equivalent new conditions."*<sup>27</sup>

Under the service quality rebate scheme, the CAA can impose financial penalties if airports fail to meet standards. For example, in the April-September 2008 period BAA was required to pay £7.34 million (\$11.5 million) in rebates to airlines after failing to meet the CAA's required performance standards at London Heathrow (£4.08 million) and Gatwick (£3.26 million).<sup>28</sup> Also in 2008, the UK Competition Commission report criticized BAA for "a lack of responsiveness to the interests of airlines and passengers that we would not expect to see in a business competing in a well functioning market." Also that year, the new Terminal 5 opened with flight cancellations when a state-of-the-art baggage-handling system broke down within hours of the opening. Nevertheless, BAA's £4 billion investment in Terminal 5, which opened in March 2008, has significantly improved the level of service at Heathrow.

In July 2010, UK Transport Secretary Philip Hammond announced a set of proposals designed to improve Britain's major airports. The package of measures is designed to put passengers at the heart of how airports are run, encourage competition between airports and promote investment which will make Britain's major airports better, not bigger. In announcing the new measures, Secretary Hammond said:<sup>29</sup>

*"The way our airports are regulated is in urgent need of reform. The current economic regulation legislation dates from 1986, when the aviation sector looked very different from today.*

*"We must now put passengers at the heart of how our airports are run. We have already announced that we do not support the building of new runways at Heathrow, Gatwick or Stansted. We want to make those airports better, not bigger and that is exactly what these measures will do.*

*"These changes will help drive passenger-focused investment in airports - such as in new baggage handling equipment or building new modern facilities - and they will also allow economic regulation to be used in a more targeted way and remove unnecessary bureaucracy."*

The winter storms that caused mass flight cancellations and havoc for passengers just prior to the 2010 Christmas holiday triggered strong reactions from European regulators of airports. Airports across Western Europe have been accused of serious under investment in winter equipment and staff. The Vice President the European Commission issued a statement condemning the performance of airports during the storm:<sup>30</sup>

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<sup>27</sup> *Economic Regulation of Heathrow and Gatwick Airports, 2008-2013, CAA decision*, Civil Aviation Authority, March 11, 2008.

<sup>28</sup> *BAA fined for substandard performance at Heathrow, Gatwick*, ATW Daily News, October 29, 2008.

<sup>29</sup> Department for Transport, *Improving Britain's Airports*, Press Release, July 21, 2010.

<sup>30</sup> Statement by Vice President Kallas on air travel disruption across Europe, MEMO/10/700, December 21, 2010.

*"In recent days, I have become increasingly concerned about the problems relating to the infrastructure available to airlines – airports and ground handling - during this severe period of snow. It seems at this stage that this is a "weak link" in a chain which, under pressure, is contributing to severe disruption.*

*I intend to convene a meeting with airports representatives in the coming days to ask for further explanations and to take a hard look at what is necessary to make sure they would be able to operate more effectively in the similar situations in the future.*

*Airports must "get serious" about planning for this kind of severe weather conditions. We have seen in recent years that snow in Western Europe is not such an exceptional circumstance. Better preparedness, in line with what is done in Northern Europe is not an optional extra, it must be planned for and with the necessary investment, particularly on the side of the airports.*

*We need to ensure that, from infrastructure providers such as airports and rail infrastructure managers, there are appropriate service levels and minimum quality requirements that are followed and delivered. If there is a need for support from the European Commission in terms of regulation on minimum service requirements for airports in this area, I am prepared to do that, for example, when we bring forward the Airports package on slots and ground handling which is foreseen before summer next year."*

In the UK, the Transport Secretary, Philip Hammond said BAA should be punished for disrupting travel plans for tens of thousands in the winter freeze. Mr. Hammond said it was unacceptable that BAA faced no punishment from the Civil Aviation Authority ("CAA") under the current regime, noting:<sup>31</sup>

*"There should be an economic penalty for service failure. Greater weight needs to be given to performance and passenger satisfaction."*

This episode prompted British ministers to say they plan to introduce new laws to allow regulators to fine airports for travel disruption.<sup>32</sup>

## **G.12.2 Australia Airport Experience**

The Australian Competition and Consumer Commission ("ACCC") monitors quality of service at the five largest price-monitored airports: Adelaide, Brisbane, Melbourne (Tullamarine), Perth, and Sydney (Kingsford Smith).<sup>33</sup> Quality of service monitoring by the ACCC was introduced in 1997 to complement price controls when airport privatizations began. Initially it applied to seven price-monitored airports and a wide range of services, but as a result of amendments to the Airports Act and Airports Regulations on July 1, 2007, Canberra and Darwin airports were excluded from the ACCC's monitoring report, the scope of ACCC's monitoring was refined to include only aeronautical services and car parking services,<sup>34</sup> and the monitoring of price and quality of service were combined into a single report. Under the amended legislation, a self-administered price and quality of service monitoring and reporting regime apply to second tier airports such as Canberra and Darwin, which must disclose on their websites results of their customer/passenger satisfaction surveys.

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<sup>31</sup> Transport secretary considers fines for airport chaos, guardian.co.uk, December 26, 2010.

<sup>32</sup> Alice Ritchie, Britain mulls new airports law after Heathrow chaos, AFP, December 26, 2010.

<sup>33</sup> *Airport monitoring report 2008–09: Price, financial performance and quality of service monitoring*, Australian Competition and Consumer Commission, March 11, 2010.

<sup>34</sup> As a result of users questioning the reliability and usefulness of some of the services being monitored and to continue to monitor the range of facilities subject to price monitoring.



The primary function of the monitoring is to ensure that airport operators do not degrade service standards as a means of reducing costs and increasing profit. The Australian Government acknowledged the potential for airports to exercise their market power at the expense of users—including the capacity for airports to provide services below community expectations or to neglect the maintenance of essential national infrastructure.<sup>35</sup>

The ACCC uses passenger and airline satisfaction surveys to gather information on the quality performance of the airports as well as surveys of government agencies (Airservices Australia, the Australian Customs and Border Protection Service (AC&BPS), the Australian Quarantine and Inspection Service, and the Department of Immigration and Citizenship). In addition, the airports supply the information to the ACCC.

As noted in its 2010 report: “*The ACCC’s analysis potentially indicates that Sydney Airport has increased profits by permitting service-quality levels to fall below that which could be expected in a competitive environment over a sustained period.*” It also indicated inadequate maintenance at the airport. Other parties were also critical of the delay in investment and degradation of services at Sydney, including the Australian Competition Tribunal referring to the airport’s “monopolistic conduct.”

The ACCC did note that Sydney Airport recently commenced construction of major expansion and refurbishment of the T1 International Terminal, but questioned whether it should have been carried out earlier. In response, the airport criticized the ACCC report as “out of date” and added that construction, which began on its A\$500 million upgrade of the terminal in October 2007, “may have. . . impacted on the customer experience.”<sup>36</sup>

### **G.13 Summary of Stakeholder Views**

As noted above, privatization is not always in the best interest of all stakeholders given its inherent risks and rewards. The balance between risk and reward depends on the unique circumstances for each airport and the means by which the public owner chooses to implement privatization.

In general, the key interests of the stakeholder groups can be summarized as shown in Table G.4.

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<sup>35</sup> *National aviation policy white paper: flight path to the future*, Department of Infrastructure, Transport, Regional Development and Local Government, December 2009.

<sup>36</sup> Brian Straus, *ACCC slams Sydney Airport for falling service quality*, ATWOnline.com, April 1, 2010.

**Table G.4. Key Stakeholder Interests**

<b>Stakeholder</b>	<b>Key Interests</b>
<i><b>Policymakers</b></i>	<ul style="list-style-type: none"> <li>▪ Ensure the airport is developed in a manner that promotes regional economic development</li> <li>▪ Create an operating environment that encourages increased passenger traffic</li> <li>▪ Raise money from a sale or lease of the airport to help pay for municipal budget deficits, pension deficits, infrastructure development, and other general purpose needs</li> <li>▪ Provide opportunity for operational efficiencies and revenue development</li> <li>▪ Provide access to private capital for airport improvements and development</li> <li>▪ Ensure the transaction is successful</li> <li>▪ Retain a degree of control over the airport assets (e.g., prices, CapEx, levels of service, noise mitigation, etc.)</li> <li>▪ Protect existing civil service employees</li> </ul>
<i><b>U.S. Airport Management</b></i>	<ul style="list-style-type: none"> <li>▪ Promote safety, security, airline service, customer service, financial stability, compliance with laws and regulations, non-aeronautical revenue development, operational efficiencies, labor stability, and other measures that enhance the reputation of the airport</li> <li>▪ Provide for the best interests of the tenants, passengers, and community over the long-term</li> <li>▪ Provide an opportunity for the government to monetize a government-owned asset (minority view)</li> <li>▪ Deploy P3 on a select basis to maximize the value to all stakeholders</li> <li>▪ Get relief from cumbersome public procurement rules and social policy mandates to operate airports more like a business than a unit of government</li> <li>▪ Reduce federal economic regulation to allow public airports more freedom</li> </ul>
<i><b>Airlines</b></i>	<ul style="list-style-type: none"> <li>▪ Reduce airline costs to operate at the airport</li> <li>▪ Provide greater predictability and stability in rates</li> <li>▪ Ensure efficient airline operations</li> <li>▪ Ensure operator meets stated operating standards</li> <li>▪ Provide sufficient capacity to accommodate demand</li> <li>▪ Provide quality level of service for passengers</li> <li>▪ Prevent monopolistic actions</li> <li>▪ Construct deal that makes business sense for the airlines</li> <li>▪ Permit consortiums for airline terminal equipment maintenance and fuel systems</li> </ul>
<i><b>USDOT/FAA</b></i>	<ul style="list-style-type: none"> <li>▪ Protect the federal government's investment in airports</li> <li>▪ Ensure airports abide by and comply with federal laws and regulations</li> <li>▪ Provide capacity to accommodate future growth</li> <li>▪ Prevent actions that would discourage growth for national airport system</li> </ul>
<i><b>Privatized International Airports</b></i>	<ul style="list-style-type: none"> <li>▪ Promote safety, security, airline service, and customer service</li> <li>▪ Take actions to increase traffic levels, drive efficiency, introduce innovation, increase non-aeronautical revenues, and produce reasonable financial returns for investors</li> <li>▪ Align operator and airline interests through per-passenger charges</li> </ul>
<i><b>Private Domestic Airport Operators</b></i>	<ul style="list-style-type: none"> <li>▪ Promote safety, security, airline service, and customer service</li> <li>▪ Maximize their financial return through operating savings, revenue enhancements, and high facility utilization</li> <li>▪ Expedite delivery of services relative to public sector rules</li> <li>▪ Minimize airline costs to the mutual benefit of the airlines, the operator, and passengers</li> <li>▪ Incentivize employees through, bonuses, succession programs, and training</li> <li>▪ Prefer light-handed regimes with no pricing regulation, because it provides the most flexibility</li> </ul>

Stakeholder	Key Interests
<b>Lenders</b>	<ul style="list-style-type: none"> <li>▪ Receive timely repayment of debt obligations at a rate commensurate with the risk</li> <li>▪ Secure senior status on debt repayment</li> <li>▪ Be protected against refinancing risk</li> <li>▪ Lock up as much security as possible in the case of default</li> </ul>
<b>Investors</b>	<ul style="list-style-type: none"> <li>▪ Earn a reasonable return on investment, which is dependent on the amount of risk</li> <li>▪ See an appropriate balance between equity and debt to maximize returns</li> <li>▪ Minimize exposure to political and regulatory risk</li> <li>▪ Invest for the time horizon desired</li> <li>▪ Conduct the transaction under a transparent process</li> <li>▪ Have access to relevant data to conduct due diligence</li> <li>▪ Provide for a clear and credible timetable for the process</li> <li>▪ Minimize the cost of participating, especially in the initial round</li> </ul>
<b>Financial Advisors</b>	<ul style="list-style-type: none"> <li>▪ Provide the most advantageous conditions for the financial offering</li> <li>▪ Protect the airport owner's long-term financial interests</li> <li>▪ Maximize the potential for the transaction's success</li> <li>▪ Explain which risks can be passed to the private investors and which cannot</li> <li>▪ Develop a reasonable estimate of the value of the transaction and manage the government's expectations regarding the value of the transaction</li> </ul>
<b>Rating Agencies</b>	<ul style="list-style-type: none"> <li>▪ Assess potential for a project or airport to generate adequate cash flow to pay bondholders with special attention paid to risks and risk allocation (including refinancing risk) and flexibility to deal with adverse conditions</li> <li>▪ See debt fully repaid by end of the concession with an appropriate "tail period"</li> <li>▪ See strong legal provisions</li> <li>▪ Have the ability to withstand financial stress tests</li> </ul>
<b>Labor</b>	<ul style="list-style-type: none"> <li>▪ Protect employment stability, pensions, and compensation levels</li> <li>▪ Advocate policies that support a union-friendly outcome</li> <li>▪ Participate in all activities, including design, construction, maintenance, and operation</li> <li>▪ Ensure the interests of its members are protected</li> <li>▪ Maintain and expand the unionizing and collective bargaining rights of their members</li> </ul>
<b>Passengers</b>	<ul style="list-style-type: none"> <li>▪ Experience high-quality, fast, reliable, safe, hassle-free, and comfortable trip through airports</li> <li>▪ Be charged reasonable prices</li> <li>▪ Have access to a wide variety of concession opportunities and other amenities</li> </ul>

## G.14 References

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## Appendix G.1

### Stakeholders Interviewed/Focus Group Participants

Below is a list of some of the stakeholders interviewed for this task.

Organization	Participant	Participant Position
<b>Policy-Makers</b>		
Columbia Metropolitan Airport (South Carolina)	Elsie Rast-Stuart	Chair of Richland-Lexington Airport District Commission
Metropolitan Airports Commission (Minneapolis-St. Paul)	Jack Lanners	Commission member
Flathead Municipal Airport Authority, Glacier Park International Airport	Jim Trout	Authority member
<b>US Airport Managers</b>		
Port of Seattle	Mark Reis	Aviation Director
San Diego Regional Airport Authority	Matt Harris	Senior Director, Executive Office
Metropolitan Washington Airports Authority	Lynn Hampton	President and CEO
Milwaukee County Aviation Division	Tim Karaskiewicz	Airport Counsel
McCarran International Airport	Randy Walker	Director of Aviation
Allegheny County Aviation Authority	Brad Penrod	Executive Director/CEO
Huntsville International Airport	Rick Tucker	Executive Director
Naples Municipal Airport	Ted Soliday	Executive Director
Metropolitan Airports Commission	Mitch Kilian	Director of Governmental Affairs
Kansas City Aviation Authority	Mark VanLoh	Director of Aviation
Chicago Midway International Airport	Erin M. O'Donnell	Managing Deputy Commissioner
Austin-Bergstrom International Airport	Jim Smith	Executive Director
Louis Armstrong New Orleans International Airport	Iftikhar Ahmad	Director of Aviation
<b>International Airports</b>		
Sydney Airport Corporation Limited	Max Moore-Wilton	Chairman, of Sydney Airport Corporation Limited Chairman-ACI-World Board
Sydney Airport	Dominic Schuster	Former Manager Aviation Pricing and Economics
BAA	Stuart Condie	Former Director of Regulation, Director Planning Services and Chief Economist
Gatwick Airport	Liz Trevor	Head of Sustainability
Saskatoon Airport Authority Canada	Bill Restall	President & CEO
<b>Airlines</b>		
American Airlines	Timothy K. Skipworth	Associate General Counsel
American Airlines	Mike Wesche	
Southwest Airlines	Michael J. AuBuchon	Senior Attorney
Air Transport Association	Laura McKee	Managing Director - Airport Affairs
Board of Airline Representatives of Australia	Warren Bennett	Executive Director
Qantas	Hans Mitterlechner	Formerly filled various positions within Qantas
Flybe	Martin Saxton	Director of Commercial Planning

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<b>Organization</b>	<b>Participant</b>	<b>Participant Position</b>
<b>USDOT/FAA</b>		
FAA, Office of Airports	Catherine M. Lang	Acting Associate Administrator, Office of Airports
FAA, Office of Airports	Randall Fiertz	Airport Compliance & Field Operations
USDOT, Office of Aviation and International Affairs	Susan Kurland	Assistant Secretary of Aviation and International Affairs
USDOT, Office of General Counsel	Nancy Kessler	Senior Attorney
USDOT	Brian Swanson	Transportation Industry Analyst
<b>International Regulators</b>		
Australian Competition and Consumer Commission (ACCC)	David Salisbury and colleagues	Director - Transport Monitoring and Analysis
UK Civil Aviation Authority	Nick Fincham	Former Head of Economic Regulation and Competition Policy
<b>Private Airport Operators</b>		
YVR Airport Services Ltd.	Amit Rikhy	Vice President, Business Development
ADC & HAS Airports	Rick Vacar	Senior VP Development
LCOR, Inc.	David Sigman	Executive Vice President & Principal
Aviation Facilities Company Inc.	Charles Stipancic	President and CEO
<b>Lenders</b>		
Crédit Agricole CIB	Gherardo Baruffa	Managing Director
<b>Investors</b>		
Global Infrastructure Partners	David Robinson	Vice President
Hochtief AirPort	Holger Linkweiler	Managing Director
MAp Europe	Martyn Booth	Head of MAp Europe
<b>Financial Advisors</b>		
Infrastructure Capital Advisors LLC	Kevin G. Carney	Managing Partner
Mayer Brown	David Narefsky	Partner
<b>Rating Agencies</b>		
Fitch Ratings	Seth Lehman	Senior Director, Global Infrastructure and Project Finance Group
Fitch Ratings	Michael McDermott	Managing Director
Moody's Investors Service	Kurt Krummenacker	Vice President - Senior Analyst
<b>Labor</b>		
Transportation Trades Department, AFL-CIO	Ed Wytkind	President
Transportation Trades Department, AFL-CIO	Larry Willis	Secretary-Treasurer

## **Appendix H**

### **Detailed Airport Case Studies**

#### **H.1 Case Study Selections**

Case studies can be a useful means of illustrating first-hand experiences and lessons learned from those experiences. The purpose of this task is to document case studies to illustrate lessons learned for a range of airport sizes, privatization strategies, and forms of governance for both successful and unsuccessful efforts. For each case study, the research team documented (1) the initial goals and objectives of the airport sponsor for undertaking the privatization initiative, (2) a summary of the process employed, (3) a summary of the business terms of the initiative, (4) documentation of the experience to date, and (5) lessons learned. Literature reviews, transaction document reviews, and interviews were used to gather information for the case studies.

Each case study considers the objectives, timeline, competitive bidding process, stakeholder interests, business terms, and the consequences (including development and operational experiences) and then presents lessons learned.

It should be noted that, where the responses of individual interview participants are referred to in this report, these represent the interviewee's own views and perceptions. However such responses have only been included to where they appear to represent opinions held more widely, or have been directly substantiated by other means

On the basis of recommendations and justifications put forth by the research team, the ACRP Panel decided to ask the team to conduct case studies of the domestic and international airports as noted below.

##### **H.1.1 Domestic Airports**

Airport System Management Contract:

1. **Indianapolis Airport Authority** – airport system comprising a medium-hub airport and 5 general aviation airports, which entered into an airport system management contract that reverted back to public operation.

Developer Financing and Operation:

2. **John F. Kennedy International Airport, Terminal 4 (JFK-IAT)** – large-hub airport, private development, financing, and operation of a major international unit terminal.
3. **Boston Logan International Airport Terminal A** – large-hub, terminal development, where private developer financing was initially considered, then airline special facility financing was undertaken, which was followed by the airline's bankruptcy resulting in a workout of the transaction documents.

Airport Privatization Pilot Program (APPP) applicants:

4. **Stewart International Airport** – non-hub airport and only airport approved under the APPP, which reverted back to public operation.

5. ***Chicago Midway International Airport*** – large-hub airport that occupies the only large-hub slot under the APPP, which was put on hold after the financial crisis in the fall of 2008.

The case studies for Stewart International Airport and Midway Airport provide interesting contrasts and helpful background for any airport considering privatization under the APPP.

Full Privatization Outside the APPP:

6. ***Morristown Municipal Airport*** – general aviation airport with long-standing, long-term airport-wide management and development agreement.

### **H.1.1 International Airports**

7. ***Sydney Airport or Kingsford Smith Airport*** -- trade sale under 99-year lease, which includes light-handed regulatory regime with relationship between privatization, regulation, and service quality (June 2002).
8. ***London Gatwick Airport International Airport*** -- secondary sale to pre-empt the expected actions of the UK Competition Commission, which was the largest airport transaction since the credit crunch and “Great Recession” and offers the opportunity to consider interesting issues such as competition concerns, economic regulation, pricing of risk, and financing considerations (December 2009).

The panel made the decision for the case studies on the basis of working papers submitted by the research team on the merits of the various candidates for airport case studies and the diversity to cover the full spectrum of privatization strategies and airport sizes.



## H.2 Indianapolis Airport Authority

### H.2.1 Background

Indianapolis International Airport (IND) is a medium-hub airport located 7 miles west of downtown Indianapolis. IND is operated by the Indianapolis Airport Authority, a municipal corporation formed in 1962 and governed by an 8-member Board (with 5 members appointed by the mayor of Indianapolis) that also operates a downtown heliport and 4 reliever airports (Eagle Creek Airpark, Hendricks County Airport/Gordon Graham Field, Metropolitan Airport, and Mt. Comfort Airport), collectively, the airport system.

In November 2010, 9 passenger airlines and their regional affiliates provided scheduled service from IND to 34 airports in the U.S., Canada, and Mexico. Delta Air Lines and its regional affiliates have the largest share (approximately 26%) of scheduled departing seats at IND, followed by Southwest Airlines with an 18% share and US Airways with a 13% share.<sup>1</sup> No other airline (including regional affiliates, if any) account for more than 10% of seats. IND is also the second-largest hub for FedEx Express, with approximately 650 flights per month supported by a 2-million-square-foot facility on 280 acres on airport.<sup>2</sup> Also on airport is the Indianapolis Maintenance Center, one of the largest maintenance, repair, and overhaul facilities in the world, built in 1994 for United Airlines but turned back to the Authority in 2004 as a result of United's Chapter 11 bankruptcy.

In 1994, the Board created a Managed Competition Committee to oversee a competitive bidding process for the rights to operate, maintain, and manage the airport system. Although the Board considered an outright sale or lease of the Authority's airports, it decided against doing so because of the difficulty in getting regulatory approval.

The Authority staff participated in the competitive-bidding process against four private-sector firms, but lost the competition to BAA Indianapolis LLC, a subsidiary of BAA USA, itself a subsidiary of BAA International (collectively "BAA"). At the time of executing the management contract with the Authority in October 1995, BAA operated 6 airports in the United Kingdom, including London's Heathrow and Gatwick airports, and maintained a contract with Allegheny County to manage the terminal concession program at Pittsburgh International Airport. The contract was anticipated to generate cost savings and nonairline revenue increases totaling \$100 million over its 10-year term through 2005. Under the terms of the management contract, BAA was to be compensated on the basis of savings in airline payments per enplaned passenger versus a baseline cost defined in the contract.

In 2003, the management contract was extended through December 31, 2007. However, in June 2007, the Authority and BAA negotiated an early termination of the management contract and the following month the Authority again assumed full responsibility for the operation and management of airport system. Much of the management and staff of BAA remained at the Authority in the same or similar positions following the transition to back Authority management.

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<sup>1</sup> Based on schedules published by Official Airline Guides for 2010.

<sup>2</sup> *FedEx in Indianapolis*, FedEx Corporation, <http://news.van.fedex.com/node/743>, retrieved November 10, 2010.

## H.2.2 Objectives

With the election of Stephen Goldsmith as mayor in 1991, the city ideologically pursued many privatization initiatives. The initiatives were undertaken as the city faced pension funding deficits, unfunded infrastructure needs, and increased competition from suburban municipalities for jobs. The city adopted a “managed competition” approach whereby private-sector companies competed to operate “policy-implementing” functions, with the city retaining control over “policy-making” decisions. Existing municipal departments were invited to participate in the competitive-bidding process. Between 1992 and 1997, the city outsourced more than 70 city services to managed competition with an estimated total savings of \$230 million being achieved. Non-public safety headcount fell by more than 40 percent over this period, with taxes decreasing slightly.<sup>3</sup>

After a high profile privatization of the city’s wastewater treatment operations in 1993 that resulted in operating expense savings and improved customer service, Mayor Goldsmith (who appointed 5 of the 9 Authority board members) identified the Authority as a potential managed competition opportunity. Increasing airline costs, lackluster nonairline revenue performance, and upcoming capital requirements were cited as a rationale for evaluating privatization, with airline costs being the overriding driver. Airline rates and charges at IND were calculated using an airport-system residual methodology, whereby airlines paid for the net costs of operating the airport system after a credit of all nonairline revenues. Therefore, all other things unchanged, any reductions in operating expenses and capital charges or increases in nonairline revenues would accrue to the airlines.

With the requisite infrastructure in place, the Authority hoped that private-sector management expertise would help the airport reduce airline costs, therefore attracting additional passenger and cargo airline service, and become a premier intermodal distribution hub. As stated by Stephen Goldsmith in 1999<sup>4</sup>:

*“The resulting lower airline fees should have a ripple effect that benefits the airline industry, the city, and the consumer. Taxpayers will benefit from lower airport costs because Indianapolis’ low fees and professional approach will be a magnet for increased economic activity. New maintenance facilities, air-cargo traffic, and airline routes are all rational expectations. Local customers will certainly notice an increase in service . . . Airport passengers may even notice a decrease in airfare as the number of airline routes increases.”*

In summary, the overarching objective for pursuing the airport privatization initiative was to attract new airline service and encourage economic development by reducing airline costs through increased nonairline revenues and reduced operating expenses. Other objectives were to improve customer service and quality and improve the diversity and expertise of airport staff. These objectives reflected an ideological belief that a private sector operator with airport expertise could achieve these goals inherently better than a public sector operator.

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<sup>3</sup> Hai-Chao Chang et al., *Managed Competition in Indianapolis: The Case of Indianapolis Fleet Services*, Columbia University, 2005.

<sup>4</sup> Stephen Goldsmith, *The Twenty-First Century City: Resurrecting Urban America*, Rowman & Littlefield, 1999.

### H.2.3 Timeline

A timeline for the Authority-BAA management contract and related material events is as follows:

**Table H.1. Indianapolis Airport Authority-BAA Management Contract Timeline**

January 1992	Stephen Goldsmith sworn in as mayor of Indianapolis
October 1992	Midfield Terminal opens at Pittsburgh International Airport; BAA USA introduces “Air Mall” terminal concession concept with name-brand stores and “street pricing”
Late 1993	City of Indianapolis enters into contract with private consortium to operate two wastewater treatment plants
Summer 1994	Indianapolis Airport Authority forms Managed Competition Committee
September 1994	Authority issues request for proposals to operate, maintain, and manage the airport system
March 1995	BAA selected as winning bidder
March–September 1995	Negotiation of management contract takes place between Authority and BAA
October 1, 1995	10-year management contract becomes effective; BAA assumes operational responsibility for airport system
January 1998	BAA enters into 10-year agreement with Susquehanna Area Regional Airport Authority (SARAA) to manage Harrisburg International and Capital City airports
July 2001	Susquehanna Area Regional Airport Authority terminates BAA management contract citing the authority’s concerns about declines in passenger traffic and BAA’s administration of the airport system
January 2003	IND management contract extended 5 years through December 31, 2007
June 14, 2007	BAA and Authority agree on terms to terminate the management contract
July 17, 2007	Management contract terminates; all personnel and operations transferred back to Authority responsibility
November 11, 2008	Col. Harvey Weir-Cook Midfield Terminal opens at Indianapolis International Airport

### H.2.4 Competitive Bidding Process

After evaluating options through the Managed Competition Committee, the Board issued a request for proposals (RFP) in September 1994. Respondents were asked to detail their plans to achieve four goals<sup>5</sup>:

- Provide better service at the same or reduced cost
- Attract economic development at Indianapolis International Airport
- Improve the airport’s long-term competitive position
- Increase the expertise and diversity of Airport staff

The bidders were asked to provide the following:

<sup>5</sup> Id.

- Management and operations plan
- Development and investment strategy plan
- Business plan
- Transition plan

Five bidders responded:

- BAA
- Authority staff
- Johnson Controls World Services
- Lockheed Air Terminal
- Tishman

All private-sector bidders had experience operating airports or airport terminals. The bidders identified revenue enhancement opportunities with improved concessions, new parking products, and enhanced commercial development. Cost saving opportunities identified by the respondents principally involved outsourcing operations such as janitorial and shuttle buses with third parties.

The proposal submitted by the Authority staff identified many of the potential improvements identified by the private-sector proponents, including street pricing and many of the other nonairline revenue enhancement and operating expense reductions proposed by other bidders. In advance of its bid for the budget year 1995, the Authority implemented operating expense reductions of \$1.7 million (approximately 5%). As a municipal department, however, the Authority was not legally permitted to propose in a joint venture with a private company, make contractual guarantees for improved performance, or commit any of its own capital toward capital improvements.

In March 1995, BAA was selected as the preferred bidder on the basis of its experience in managing its airport system in the UK, serving more than 80 million passengers in total. (The other private-sector bidders had experience managing either only terminals or non hub airports.) BAA's success in managing the concession program at Pittsburgh's new Midfield Terminal was also cited as a factor affecting the decision and its international air service development experience. While BAA proposed to receive a management fee consisting of both fixed and variable portions, during negotiations it agreed to the fee being entirely variable and dependent upon contractual goals being met.

## H.2.5 Stakeholder Interests

**Authority Board.** As noted earlier, the Board's main interest was to increase economic development by stimulating new airline service. The Board felt that it could achieve this goal through reduced airline costs, and that this goal could be best achieved through a managed competition process in which private sector companies would guarantee increases in nonairline revenues and decreases in operating expenses. The privatization effort was, in large part, a continuation of similar privatization efforts by the city of Indianapolis.

**BAA.** BAA was created in 1987, as part of the British privatization efforts of the Thatcher administration and was less than a decade old at the time of the issuance of the Indianapolis RFP. BAA anticipated similar privatization efforts around the world and was motivated to expand its reach. Having recently implemented a successful concessions program at Pittsburgh International

Airport, BAA believed the U.S. would be a logical market for future privatization.<sup>6</sup> The Indianapolis opportunity was attractive as it entailed the management of all airport operations, including operations at the Authority's reliever airports. BAA believed that experience gained at Indianapolis would position it well for similar opportunities in the future. BAA also viewed the contract as an opportunity to sell other services, such as planning and construction management, an important consideration since a new midfield terminal was contemplated during the term of the management contract.

**Airlines.** Airline interests included reduced rates and charges, maintaining capital project approval ("majority-in-interest") rights, and ensuring that any monies generated on airport remained in the airport system and were not diverted to other purposes. While the airlines were opposed in principle to paying management fees for a private operator, they were the beneficiary of efficiencies achieved at the airport as a result of the "residual" methodology employed for the calculation of airline rates and charges. Notwithstanding this benefit, the airlines regularly questioned the value BAA contributed in relation to its annual fee.

**Labor.** As noted earlier, Authority staff ("Team IND") submitted a proposal to manage and operate the airport system and were keen to continue to run the entity. Team IND felt that they had earned the credibility and confidence of the airlines, which was a critical concern, as demonstrated by letters of support from the airlines in its proposal. In addition, Team IND felt that it had already demonstrated innovative management practices. Team IND also committed to outsourcing janitorial services and general aviation airport operations as well as managed competition of all parking facilities, ground transportation facilities, and shuttle bus operations, but to require the private subcontractors to hire all existing Authority employees in those positions under terms and conditions similar to those in place at that time. A lower wage scale would have been permitted for new hires, but Team IND wanted to protect existing employees.

As noted later, the management contract required BAA to use its best efforts to employ all Authority staff and offer each employee an initial compensation and benefits package similar to what the employee was receiving as an Authority employee. Substantially all Authority staff became employees of BAA.

## H.2.6 Business Terms

After being selected as the winning bidder in March 1995, BAA and the Authority negotiated the terms of the management contract, which took effect on October 1, 1995. The agreement gave BAA the exclusive right to operate, maintain, and manage the airport system for 10 years. The agreement contained an option to extend the term in the seventh year of the agreement for a term mutually acceptable to the Authority and BAA. While the agreement focused on operations at the airport, BAA was also charged with the operation of the reliever airports.

**Scope of Services.** The scope of services was organized into three components, with functions as follows:

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<sup>6</sup> BAA USA was also retained as the master developer and manager of the retail, food, and beverage operations for Boston Logan International Airport (Terminals B and E) in July 2000, the new concourse at Baltimore/Washington International Thurgood Marshall Airport in March 2004, and Cleveland Hopkins International Airport in February 2008. In addition, BAA was retained to manage Harrisburg International and Capital City airports on behalf of the Susquehanna Area Regional Airport Authority in January 1998.

1. Terminal services
  - Terminal maintenance and janitorial
  - Terminal operation
  - Terminal concessions
  - Parking and rental car
  - Terminal advertising
  - Grounds maintenance
  - Terminal security
  - Planning and engineering for terminal
  - Terminal land development
  
2. Airfield support services
  - Airfield maintenance and snow removal
  - Ramp operations
  - Airfield signage and navigation
  - Fire and rescue
  - Reliever and general aviation airports and heliport
  - Non-terminal buildings maintenance
  - Fixed-based operator and general aviation facilities maintenance
  - Vehicle maintenance
  - Intermodal and cargo support
  - Planning and engineering for airfield
  - De-icing
  - Airside land development
  - Airside security
  - Fuel farms and fill stands
  
3. Administrative support services
  - Finance and accounting
  - Grant management
  - Management information systems
  - Public relations, including noise abatement programs
  - Human resources management
  - Purchasing and contracts management
  - Administration of bond issuance and PFC collection and accounting
  - Land acquisition and relocation implementation
  - Legal
  - Air service marketing, including freight

BAA was charged with administering and enforcing all agreements maintained by the Authority, subject to the policy decisions of the Board. The planning function as identified in the scope of services was limited to the scope of strategic planning historically performed by the Authority and excluded those services that were typically bid out to third-parties (e.g., master planning). BAA was allowed to bid competitively to provide such expanded planning services, but with no preference over other bidders. Any revenues to be received by BAA for providing such services were to be

retained in full by BAA and were not to be considered under the terms of the management contract. BAA was responsible for managing the implementation of capital improvements, subject to approval by the Board and any other responsible parties (e.g., the FAA) in compliance with all governmental regulations.

The Authority retained under its control the following functions:

- Airline use agreement compliance
- Compliance with the authority's obligations under the law and under federal grant agreements
- Air service development policy
- Debt issuance policy
- Rates and charges policy
- Long-range planning
- Land acquisition and development policy and planning
- Airport industrial and economic development policy
- Environmental policy
- Capital expenditure policy and implementation of capital improvements

***Oversight.*** Under the terms of the agreement, BAA was required to appoint an airport director to serve as its liaison with the Board. The agreement allowed the Authority to appoint one or more persons to assist the Board with contract compliance issues. The airport director was not accountable to any such Authority personnel, but was encouraged to cooperate fully with any requests.

***Compensation.*** As noted earlier, the Authority's main objective in contracting with BAA was to reduce airline payments per enplaned passenger as an inducement for the airlines to provide more air service and thus stimulate economic development. Under the agreement, any expenses incurred by BAA on behalf of the operation and maintenance of the airport (under the terms of its agreement), net of nonairline revenues, were to be recovered from the airlines, consistent with the approach before BAA assumed operational responsibility.

During negotiation of the management contract, BAA and the Authority agreed to share in the reduction in airline payments per enplaned passenger versus a "baseline" projected assuming no efficiencies were gained. The savings were calculated annually as the difference between the baseline and actual airline payments per enplaned passenger number, times the number of enplaned passengers for that year. The agreement provided for BAA to receive 32.5% of the savings as a management fee, subject to a \$4 million annual cap, escalated for inflation. The Authority's share of the savings (67.5%) would accrue to the airlines in the form of reduced rates and charges. (In essence, the airlines were to receive \$0.675 of every \$1.00 of savings produced by BAA.)

A hypothetical illustration of the calculation is provided in the Table H.2.

**Table H.2. Illustrative Calculation of the BAA Management Fee per the Management Contract**

Baseline airline payments per enplaned passenger	[A]	\$5.00
Airline payments per enplaned passenger before management fee	[B]	\$4.50
Difference	[C=A-B]	\$0.50
Enplaned passengers (in 000s)	[D]	4,000
Savings (in 000s)	[E=C*D]	\$2,000
BAA share (management fee, in 000s)	[F=0.325*E]	\$650
Authority share (to airlines in the form of reduced rates and charges, in 000s)	[0.675*E]	\$1,350
Airline payments per enplaned passenger after management fee	[B+(F/D)]	\$4.66

The baseline was subject to adjustment to neutralize the effect of the following:

- Implementation of capital projects and increases in debt service
- All parking revenues and incremental expenses associated with new parking products
- Difference between actual inflation and inflation assumed in the baseline projections
- 60% of voluntary severance costs
- Additional operating expenses incurred as a result of accounting changes or legal mandates
- Bad debts
- Costs that were the responsibility of the Authority under the agreement, including contract compliance
- Other items subject to annual negotiation

If enplaned passenger levels varied by more than 10% (up or down) in any given year versus the baseline projection, the parties were required to negotiate in good faith an appropriate adjustment to the projection. Subject to these provisions, BAA committed to guaranteed minimum reductions in airline payments per enplaned passenger against the baseline for the 13-year period of the agreement (10-year term plus 3-year option period). The guaranteed minimum reduction per passenger (in 1994 dollars) was \$0.27 in the first year of the agreement, \$0.57 in the second year, and \$0.456 in the remaining years. The management fee was to be paid monthly on the basis of actual performance versus budget, with a reconciliation following the annual audit.

In addition to the management fee, BAA was eligible for a 5% “quality bonus” for meeting certain quality improvement goals, with goals set annually as part of the budget process. BAA was also eligible for an incentive fee at the Board’s discretion for developing new parking products.

During 2002 (and into early 2003), the Authority and BAA negotiated an amendment to the management contract, which was contemplated in the seventh year of the contract. Both parties had an incentive at the time to negotiate the extension. The Authority was motivated to change the compensation structure, as the annual processes required to calculate the fee became increasingly difficult to administer. Although BAA had two other U.S. contracts at the time (Pittsburgh and Boston Terminals B and E), these contracts were limited to managing only concession programs. BAA still viewed its contract with the Authority as important experience in anticipation of similar



opportunities arising in the future especially after having its management contract for the Harrisburg airport system terminated in mid 2001. BAA also saw the extension as an opportunity to market planning and development services related to the Midfield Terminal redevelopment, which was at the time expected to be completed by 2007.

The amended agreement changed the compensation methodology by providing for a fixed and a variable component. The fixed fee was set at \$555,000 per year in 2003 dollars and was intended to compensate BAA for its expertise in airport management. The variable fee (the “performance fee”) was capped at \$1,295,000 per year in 2003 dollars and was intended to allow for BAA to be compensated on the basis of performance achieved towards different goals as opposed to a single goal (i.e., reduction in airline payments per enplaned passenger). The goal areas and their shares of the maximum performance fee were set as follows:

- Financial results (20%)
- Safety and security (20%)
- Customer relations (20%)
- Operation and maintenance (25%)
- Capital program management (15%)

Specific targets were set each year as part of the budget process. BAA was evaluated annually against progress towards these targets, receiving 70% of the maximum fee for each segment for minimal performance towards meeting target, 85% for meeting target, and 100% for outstanding performance towards meeting target. BAA also guaranteed minimum performance and was obligated to pay to the Authority up to \$400,000 per year if it received less than 50% of the maximum performance fee. Under the revised agreement, BAA’s minimum annual compensation was \$150,000 (the \$550,000 fixed fee less the maximum \$400,000 penalty).

BAA management fees paid during the term of the management contract are provided in the later section “Consequences.”

**Personnel.** The management contract required BAA to use its best efforts to employ all Authority staff. BAA was required to offer each employee an initial compensation and benefits package similar to what the employee was receiving as an Authority employee. BAA was also required to offer health insurance coverage under its own group plan. Concurrent with the effective date of the management contract, the Authority terminated its defined benefit pension plan, with employees eligible to rollover accumulated balances into a defined contribution plan offered by BAA. Severance costs related to any voluntary attrition of employees were shared by BAA (40%) and the Authority (60%, subject to a cumulative cap of \$480,000). The agreement also required BAA to institute an employee training and development plan intended to improve staff’s airport management expertise.

**Other Provisions.** The agreement required BAA to implement the customer survey program included in its proposal. BAA was also required to implement the “street pricing” program pioneered at Pittsburgh International Airport to ensure that the price of goods and services offered at airport concessionaires were on average the same as those in non-airport retail outlets in the Indianapolis area.

BAA was not released from the requirements of Authority procurement ordinances. All operating contracts entered into by BAA with a value of more than \$50,000 were subject to written approval

by the Board. BAA covenanted to make its best efforts to meet Authority disadvantaged business enterprise (DBE) goals.

## H.2.7 Consequences

Although the Authority initially viewed the managed competition concept as a way to change the way business was conducted over the long term at the airport, the Authority reassumed control of the airport system following the early termination of the agreement in June 2007. In the end, not all of the expectations were met. The Authority acknowledged that BAA was successful in gaining certain efficiencies and conceded that BAA was able to do so more quickly than the Authority may have been able to do so otherwise. There is also general agreement that BAA's operation was beneficial for staff as a whole, as employees gained broader airport management expertise and the opportunity to interact with colleagues in the United Kingdom. This interaction was valuable, as it brought to staff the private sector airport management perspective.

BAA assumed operational control in the year that reflected budget cuts implemented by the Authority in advance of the competitive bidding process. Under the terms of the management contract, in which the baseline was projected from the year before the reductions, BAA received the benefit of most of these operating expense cuts. As rental car and terminal concession agreements expired, BAA negotiated more favorable financial terms. BAA fully implemented the successful Pittsburgh "AirMall" concept with street pricing at the airport, which it later introduced at the airports serving Baltimore, Boston, and Cleveland. Although various attempts were made to increase parking revenues with the introduction of new products such as valet parking, most of these initiatives were not deemed to be particularly effective. While BAA did pursue outsourcing of services such as janitorial, in general, the savings were not significantly greater than the contracts the Authority already had in place. Air service marketing efforts were expanded, but without achieving the desired effect of new international service.

From the first year of the contract, it became apparent that the compensation methodology prescribed by the agreement would be difficult to administer. Since under the residual airline ratemaking structure, the airlines ultimately paid BAA's management fee, they lobbied the Authority to ensure that BAA did not receive the benefits of "windfall improvements" not subject to its control. To protect its financial interests, BAA spent much time and effort in documenting and estimating the effects of its efforts. The financial effect of many of BAA's initiatives such as implementing a new customer complaint program for parking operations, employee training programs, and new schedules and other changes to shuttle bus operations were impossible to measure meaningfully. Internal documents prepared by BAA in support of its proposed compensation calculation illustrate the structural problems with the compensation calculation that were experienced throughout the term of the contract:<sup>7</sup>

*"Not all of [the initiatives being implemented by BAA] may be directly financially appraised, but all will contribute to the enhancement of customer service and safety and therefore indirectly enhance revenue streams and facilitate cost savings."*

The structure of the compensation calculation dis-incentivized BAA from implementing any customer service initiative that resulted in increased operating expenses, even though improved

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<sup>7</sup> *Compensation Calculation, 1 October 1995 to 31 December 1996*, BAA Indianapolis LLC, August 1996.

customer service was cited as a goal during the competitive bidding process and was supported by the spirit of the management contract. While the parties attempted in good faith to use a more technical approach to identify appropriate baseline adjustments in the initial years of the contract, the annual compensation calculation eventually became more of a negotiation. The negotiation became more contentious as the baseline projected in 1994 became increasingly meaningless as a result of changes in the airline industry, the economy, and new security requirements as a result of September 11.

The Authority began planning efforts for the Midfield Terminal redevelopment during the term of the management contract. BAA viewed the redevelopment as an opportunity to market new services such as planning and construction development to the Authority. Such services would have been considerably more profitable to BAA than the management contract and were part of BAA's rationale in pursuing the contract in the first place. However, BAA did not realize any opportunities as the Authority engaged other outside parties. In 2000, the Authority engaged its own Executive Director, to manage its Capital Improvement Program, which included the \$1 billion new Midfield Terminal. Over time, as the calculation of the management fee became increasingly contentious, and BAA's views on the Midfield Terminal project diverged from the Board's view, the Executive Director assumed an increasing role as the Board's liaison with BAA's airport director. This experience accounts, in part, for the change in compensation structure negotiated by the Board for the extension term.

As discussed previously, the overarching objective of the management contract was to attract increased airline service and economic development. The Board felt that it could achieve such goals by reducing airline costs and outsourcing airport management to a private-sector operator with airport expertise. With these goals in mind, the Board negotiated what it believed to be a performance-based compensation structure. While the experience of the Authority and BAA demonstrates the inherent difficulty in measuring the success of a private sector operator versus a public sector operator, trends in the following metrics can be used in part to analyze success versus goals stated by the Authority during the competitive bidding process:

- Enplaned passengers
- Airline payments per enplaned passenger
- BAA management fee

***Enplaned passengers.*** As shown in Table H.18, between 1995 and 2007, enplaned passengers (in millions) at IND increased an average of 1.8% per year, which was lower than the average for the nation as a whole (2.6%). The lower rate for IND can be explained, however, in large part, as a result of changes in airline service. ATA Airlines, based at IND, liquidated and suspended its scheduled low-fare operations in 2006. Northwest Airlines built up service from IND to major business markets beginning in 2004, but discontinued a portion of the service following its merger with Delta Air Lines in 2008. Both events were outside of the control of BAA and the Authority. Regardless of these events, the trend does not suggest that BAA had success in air service development efforts. In particular, BAA was unsuccessful at attracting international air service, which was a stated goal of the Authority, other than seasonal charter service.

**Table H.3. Enplaned Passengers, Indianapolis (IND) and United States**

Year	IND (a)	Percent annual change	U.S. (b)	Percent annual change
1995	3.4	n.a.	572.0	n.a.
1996	3.5	5.4%	604.8	5.7%
1997	3.6	1.4%	624.6	3.3%
1998	3.7	1.8%	640.2	2.5%
1999	3.7	2.1%	666.9	4.2%
2000	3.9	4.0%	694.9	4.2%
2001	3.6	-6.6%	646.1	-7.0%
2002	3.4	-4.7%	633.4	-2.0%
2003	3.7	6.6%	666.5	5.2%
2004	4.0	9.4%	721.7	8.3%
2005	4.3	5.9%	751.7	4.2%
2006	4.0	-5.0%	753.9	0.3%
2007	4.1	2.4%	778.5	3.3%
Average annual increase				
1995 - 2007		1.8%		2.6%
(a) Indianapolis Airport Authority records.				
(b) U.S. Department of Transportation T100 database.				

***Airline payments per enplaned passenger.*** Table H.4 shows airline payments per enplaned passenger (in nominal and constant 1995 dollars). As shown in the table, airline payments per enplaned passenger in constant 1995 dollars exceeded the 1995 amount only twice in the 13 years in which BAA operated the airport system (2002 and 2003). The lowest numbers were achieved in the first 2 full years of operation (1996 and 1997), suggesting that BAA was able to supplement prior operating expense reductions by Authority staff with increased nonairline revenues. Airline payments per passenger peaked in 2003 and 2004 following the September 11 as a result of additional operating expenses related to increased security measures. The relative stability in airline payments over the period is attributable in part to minimal capital expenditure requirements as the existing terminal was to be replaced with the Midfield Terminal that opened in late 2008. While the data indicate general stability in airline payments during the term of the BAA management contract, it is difficult to compare with payments that would have been under continued Authority operation. As stated in the prior section “Competitive Bidding Process,” many of the improvements identified by the private sector bidders were proposed by the Authority staff.

**Table H.4. Airline Payments per Enplaned Passenger, IND and United States  
(in millions)**

	Airline payments per enplaned passenger (nominal dollars) (a)	Airline payments per enplaned passenger (1995 dollars) (b)
1995	\$5.58	\$5.58
1996	3.87	3.75
1997	3.84	3.65
1998	3.78	3.54
1999	5.02	4.57
2000	5.06	4.47
2001	6.18	5.33
2002	6.13	5.20
2003	7.15	5.93
2004	7.09	5.71
2005	6.44	5.00
2006	6.87	5.19
2007	7.38	5.41
(a) <i>Comprehensive Annual Financial Reports</i> , Indianapolis Airport Authority.		
(b) Adjusted to 1995 dollars using the U.S. Department of Labor Consumer Price Index for All Urban Consumers.		

***BAA management fee.*** Table H.5 shows the annual management fee paid to BAA. As shown in the table, payments increased every year between 1996 and 2000. As operating expenses increased and passenger numbers decreased following September 11, the management fee was reduced. The provisions of the extended agreement capped the amount that BAA was eligible to receive to a maximum of \$1,850,000 (\$555,000 fixed component and \$1,295,000 variable component) in 2003 dollars. The maximum amount under the extension term was much reduced from the maximum under the original agreement (\$4 million) and less than the amount earned by BAA in each year between 1998 and 2001, suggesting that the Authority valued BAA's services less than it had in the past.

Table H5. **BAA Management Fee**  
(in thousands)

Year	Management Fee
<b>Original Term</b>	
1996	\$1,003
1997	1,490
1998	2,265
1999	2,314
2000	2,417
2001	2,195
2002	1,003
<b>Extension Term</b>	
2003	1,459
2004	1,480
2005	1,780
2006	1,792
2007	1,976
<p>Sources:                      1996-1997: <i>Official Statement, Indianapolis Airport Authority, Refunding Revenue Bonds, Series 1998A</i>, May 21, 2008.                      1998-2007: <i>Comprehensive Annual Financial Reports</i>, Indianapolis Airport Authority.</p>	

While the data presented in Tables H.3, H.4, and H.5 do not provide empirical evidence that BAA was able to achieve financial improvements that could not have been achieved under continued Authority operation, BAA cited the following, among others, as being indicative of its success:

- Implemented new food/beverage program throughout IND, introducing brand-name outlets with guaranteed street prices
- Completed a terminal refurbishment program with new lighting and carpeting, fresh paint, and new signage.
- Opened the airport's first fueling station and convenience center, which improved customer service at the airport's facilities.

In the first year after the Authority resumed operation (2008), the Authority reported that administration costs decreased \$1.1 million, or 8.7% from the prior year, which was primarily attributable to the termination of the management contract.

## H.2.8 Lessons Learned

Lessons by the stakeholders in this airport system management contract included the following:

- Government departments competing in managed competition efforts can be disadvantaged, as regulations generally prevent them from partnering with private firms or guaranteeing performance. Evaluation criteria may need to be assessed with this potential conflict in mind.
- Whatever metrics are used to gauge performance should be transparent and easily measurable. Improvements made by BAA as measured by airline payments per enplaned passenger were difficult to track as they required the estimation of a hypothetical baseline comparison (including numerous categories of operating expenses and nonairline revenues, which can be extremely variable from year to year). Over the long-term agreement, especially after the operational changes necessitated by increased security measures following the September 11, 2001 terrorist attacks, it became increasingly difficult to estimate meaningfully what the baseline would have been. In this respect, the annual management fee became an annual negotiation between the Authority and BAA and was frequently contentious.
- Tracking contract compliance became a substantial undertaking for the Board, which eventually hired professionals with airport and public management expertise to oversee the contract. Much time was spent defining a peer set of airports to use for benchmarking BAA's performance, with inconclusive results.
- Once initial efficiencies had been gained by BAA, it became difficult to make ongoing improvements with effects similar in magnitude. For this reason, a strategy may be to contract with a private-sector firm on a short-term basis to gain the majority of potential efficiencies before transferring the operational responsibilities back to the public sector. The Authority-BAA contract worked in this regard to the extent that staff gained broader, international airport management expertise during the term of the contract.
- From BAA's perspective, once initial efficiencies were attained, it became increasingly difficult to attain further improvements and realize the full value of the management fee. Moreover, the relatively small maximum annual compensation amount (initially \$4 million, reduced later to \$1.85 million), while appropriate for a firm that may have viewed the opportunity as a "loss leader" necessary to achieve more lucrative contracts in the future, may not have been enough of an incentive to attain more difficult-to-achieve improvements.<sup>8</sup>
- When many goals are trying to be achieved through privatization, the compensation needs to be tied to each goal. The initial compensation structure for BAA was tied to improvement in one variable—airline payments per enplaned passenger—and not separately to the individual goals the Authority was trying to achieve (e.g., improved customer service and

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<sup>8</sup> As a point of reference, the management fee for airport management services for Albany International Airport was fixed at \$407,286 in 2010, an airport that accommodated 1.3 million enplaned passengers in 2009, compared with IND's 3.7 million enplaned passengers.

new air service). The amended agreement changed the compensation structure so that BAA was compensated for its progress against separate goals, but the new structure may also have been difficult to truly measure efficiencies for the purpose of justifying compensation.

- To achieve the full benefits of privatization, it may be more effective to contract with multiple firms specializing in each area in which improvement was targeted. While BAA had successful U.S. experience with concession programs, other firms may have had more expertise in areas such as parking or building maintenance. While the management contract allowed BAA to contract with other firms, BAA often was incentivized to maintain as much control as possible.
- With few exceptions, there were no ‘magic solutions’ that could not have been attained under continued public management. When acquiring services on behalf of the Authority, BAA was not released from Authority procurement regulations, which is often a large motivation in privatization efforts. However, BAA’s procurement of goods with their own operating funds was not considered ‘public’ dollars in the same way as the Authority’s funds. Moreover, BAA employed substantially the same staff as the Authority did before. In the end, BAA’s approach to improve performance involved typical airport management best practices to increase nonairline revenues with more advantageous contract terms, increase parking revenues without sacrificing market share, increase commercial development, and outsource non-core services. Notwithstanding these industry-accepted approaches, having a private operator involved may have streamlined and improved certain processes, especially with regard to renegotiating concession, rental car, and other nonairline contracts.

## H.2.9 References

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## H.3 John F. Kennedy International Airport Terminal 4 (JFKIAT)

### H.3.1 Background

JFK International Air Terminal LLC (“JFKIAT”) was formed in 1997 in partnership with the Port Authority of New York and New Jersey to build, operate, develop, and manage the \$1.4 billion Terminal 4 at John F. Kennedy International Airport (“JFK”). Terminal 4 replaced the original International Arrivals Building (“IAB”), which had been built, operated, expanded, and renovated by the Port Authority since 1957. Since the central terminal complex was developed in the late 1950s and early 1960s, the IAB has been the only terminal at JFK not exclusively leased, developed, and operated by airlines. For this reason, the terminal has traditionally housed the operations of numerous foreign-flag airlines, typically operating with low frequencies. (In November 2010, 38 airlines provided service at Terminal 4.)

Recognizing that the IAB no longer functioned efficiently due to insufficient capacity and outdated building systems, the Port Authority initiated in 1993 planning and design studies for redevelopment of the IAB. Realizing that the project would require significant capital investment and program management and oversight, the Port Authority decided in 1995 to involve the private sector in the design, construction, and operation of the new facility on the site of the existing IAB.

JFKIAT was selected by the Port Authority following a competitive bidding process. JFKIAT was a joint venture of LCOR JFK Airport, LLC, Schiphol USA Inc., and Lehman JFK LLC. JFKIAT assumed responsibility for the operation of the IAB and development of the new state-of-the-art international terminal building in May 1997 shortly after the financial closing of the special facility bonds issued to finance the project. JFKIAT was the first private, nonairline entity to manage an international air terminal in the United States.

Occupying 165 acres, JFKIAT controls the largest and most flexible terminal site at JFK. The 1.5-million-square foot terminal opened in May 2001 with two concourses (Concourses A and B) and 16 loading-bridge-equipped gates and an apron capable of accommodating up to 24 remotely parked aircraft. Terminal 4 is the largest international terminal in the New York area, with federal inspection services (“FIS”) facilities capable of processing 3,200 passengers per hour, and provides the only 24-hour FIS facility at JFK.

JFK’s Central Terminal Area includes 8 unit passenger terminal buildings, of which 7 are currently in use. Figure 10.1 shows the passenger terminal buildings at JFK as of November 2010.

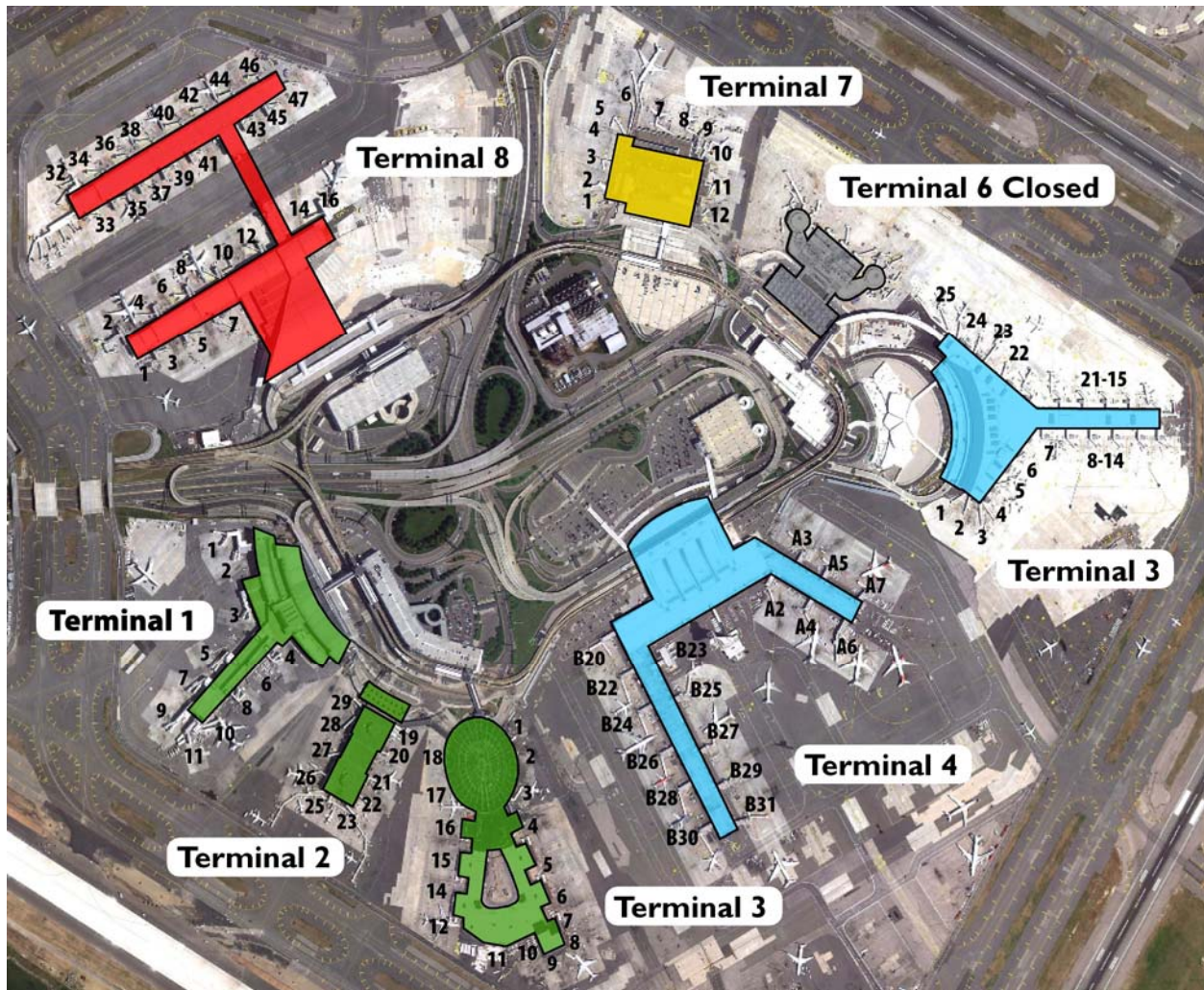
Developments since the signing of the JFKIAT in May 1997 include (1) the opening of new Terminal 1 in 1998; (2) the opening of the \$1.9-billion AirTrain rail transit system in late 2002, which connects the central terminal area with subway and regional rail systems; (3) the redevelopment of Terminal 5 at a cost of \$800 million, which opened in 2008; and (4) the redevelopment of Terminal 8 at a cost of \$1.3 billion, which opened in 2007. As of November 2010, the Port Authority’s Redevelopment Program for the central terminal area at JFK has resulted in modern passenger facilities at Terminals 1, 4, 5, 7, and 8, which primarily relied upon private investment given the Port Authority’s substantial financial commitment to the AirTrain. As of November 2010, the JFK terminals consist of:

- Terminal 1 -- operated by an airline consortium of Air France, Japan Airlines, Korean Air, and Lufthansa German Airlines, collectively the Terminal One Group Airlines (“TOGA”)

- Terminal 2/3 -- operated by Delta Air Lines
- Terminal 4 (former IAB site) -- operated by JFKIAT
- Terminal 5 -- operated by JetBlue
- Terminal 7 -- operated by British Airways with United Airlines as a major tenant
- Terminal 8/9 -- operated by American Airlines

Terminal 6 was closed upon the opening of the redeveloped Terminal 5 in 2008. The Port Authority has since approved plans to demolish Terminal 6 and use the site for remote aircraft parking or future terminal development.

Figure H.1. JFK Central Terminal Area



Source: Google Earth, accessed December 2011.

Terminal 4 was generally recognized in the industry as the preeminent example of nonairline, private sector participation in terminal development and operation, with benefits having been realized in increased operating efficiency, enhanced levels of service for passengers and airlines, and reduced operating costs.

In August 2010, JFKIAT, the Port Authority, and Delta Air Lines announced a \$660 million expansion of Terminal 4 (the “2010 Expansion Project”), which includes an extension of Concourse B to include 9 additional loading-bridge-equipped gates, new airline lounges, centralized security checkpoints, a secure-side connector to Terminal 2, the demolition of Terminal 3, and expanded remote aircraft parking facilities. Construction is expected to begin in the fourth quarter of 2010, with all work to be completed within five years.

In 2010, in connection with the proposed redevelopment, Schiphol acquired the LCOR and Lehman ownership stakes to become the sole partner. Subsequently, Delta bought a non-majority, non-controlling stake in JFK-IAT in April 2010.

### **H.3.2 Objectives**

After the election of George Pataki as New York governor in 1994, political support of privatization initiatives at state agencies increased. In this environment, the Port Authority<sup>9</sup> began considering involving private sector participation in its operations. The Terminal 4 redevelopment was identified as an attractive opportunity as its cost comprised approximately one-fourth of the cost of the agency’s 5-year capital program and the Port Authority wished to preserve future funding capacity. Other large-scale construction projects were planned or in process at JFK, including the quadrant roadway reconfiguration and the AirTrain rail transit system, which was to connect the terminal complex with subway and regional rail systems. The financial and management resources required to implement these complex projects along with the redevelopment of Terminal 4 provided further encouragement for the agency to explore alternative project delivery methods. Finally, the IAB was operationally intensive, with approximately 230 Port Authority employees staffing the facility at the time.

In summary, the Port Authority’s primary objectives in partnering with the private sector to redevelop the IAB in 1997 were:

- Preserving financing capacity
- Minimizing construction risk and management oversight
- Reducing operational responsibilities
- Delivering a functional terminal on time and on budget with no additional financing required by the Port Authority
- Improving operational efficiency and increasing terminal capacity by replacing exclusive-use arrangements with common-use arrangements and new pricing approaches
- Gaining public-private partnership experience for possible deployment to other agency operations

For the 2010 Expansion Project announced in August 2010, the Port Authority’s objectives included:

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<sup>9</sup> The Port Authority is a bi-state port district established through an intergovernmental contract between the states of New York and New Jersey. The governor of each state appoints 6 members to the Board of Commissioners, which oversees the Port Authority.

- Accommodating Delta and SkyTeam’s growth plans, which is part of a larger goal for co-location of alliance partners
- Demolishing the functionally obsolete Terminal 3
- Ensuring JFK’s continued preeminence as a premier port of entry into the U.S.
- Improving customer service and the passenger experience
- Minimizing the Port Authority’s financial commitment in favor of higher priorities, in particular, the redevelopment of the World Trade Center site

### H.3.3 Transaction and Development Timeline

A timeline for the planning, construction, and operation of Terminal 4 and related material events is as follows:

**Table H.6 JFKIAT Terminal 4 Privatization Timeline**

1993	Port Authority began planning and design studies for Terminal 4 redevelopment
July 1995	Request for qualifications issued for parties interested in operating the existing IAB and to construct and operate the new Terminal 4
December 1995	Request for proposals (RFP) issued
March 1996	RFP responses due
April 1996	JFKIAT selected as winning proponent
May 1996	Memorandum of understanding signed between Port Authority and JFKIAT and JFKIAT assumes operational responsibility
April 25, 1997	Closing of \$934.1 million in Series 6 Special Project Bonds to finance Terminal 4 redevelopment
May 13, 1997	Execution of JFKIAT lease, JFKIAT assumes operation of IAB
May 1998	Terminal 1 opens at JFK; Air France, Japan Airlines, Korean Air, and Lufthansa relocate operations from the IAB to Terminal 1
May 8, 2001	Opening of the Terminal 4 central terminal building (“head house”) with the principal facilities for processing arriving and departing passengers
August 10, 2001	Port Authority and JFKIAT agree to terms of lease amendment; Port Authority provides \$172 million in subordinate completion financing
September 11, 2001	Terrorist attacks depress international airline travel demand; most U.S. airports, including JFK, closed for 2 days
March 2002	Terminal C international arrivals facility opens at Newark Liberty International Airport; federal inspection services facilities are capable of processing up to 1,500 passengers per hour
December 2003	AirTrain transit system opens at JFK, improving access to subway and regional rail systems
November 2004	City of New York and Port Authority execute extension to Port Authority’s lease of JFK and LaGuardia airports through 2050
2007	Delta Air Lines begins negotiations with Port Authority and JFKIAT over Terminal 4 expansion

August 2007	American Airlines completes redevelopment of Terminal 8; the 1.6-million-square-foot terminal has 36 gates and includes federal inspection services facilities capable of processing up to 1,600 passengers per hour
October 2008	JetBlue opens new 26 gate Terminal 5 at JFK
April 2010	Schiphol USA acquires JFKIAT ownership stakes of LCOR and Lehman
August 11, 2010	Port Authority, JFKIAT, and Delta announce \$660 million expansion of Terminal 4
May 2013 (anticipated)	Delta to relocate fully Terminal 3 operations to Terminal 4
May 2015 (anticipated)	Terminal 3 demolished; site redeveloped to accommodate remote aircraft parking

### H.3.4 Competitive Bidding Process

The competitive bidding process was completed relatively quickly, with less than two years elapsing between the issuance of a request for qualifications (“RFQ”) in July 1995 and the financial closing of the special facility bonds issued to fund the project in April 1997. The Port Authority was motivated to expedite the process due to the pressing need to replace the IAB amid increasing traffic and its desire to mitigate cost escalation risk.

In July 1995, the Port Authority issued the RFQ to operate the existing IAB and construct and operate Terminal 4. Ten of the eleven respondents were qualified to reply to the request for proposals (“RFP”), which was issued in December 1995. The Port Authority set up a data room for the bidders to review information compiled on the project. Four proponents responded to the RFP, and JFKIAT was selected as the winning proponent in April 1996. Bidders were required to bid on the Port Authority design (at approximately the 30% stage) but could also propose alternative designs. The main criteria used by the Port Authority to judge the proposals were (1) design, functionality, and ability to construct, (2) the operational plan, and (3) financial criteria, including no Port Authority funds and the use of non-recourse bonds. The Port Authority did not want to provide a backstop to any of the development ventures.

The winning bidder was a joint venture of:

- LCOR JFK Airport LLC (“LCOR”) with a 40% stake
- Schiphol USA LLC with a 40% stake
- Lehman JFK LLC (“Lehman”) with a 20% stake

LCOR JFK Airport LLC is owned by LCOR Inc. and LCOR Investment Corp. with core business activities related to real estate development and management. LCOR has been involved with a number of high-profile real estate projects. Schiphol USA LLC is a division of Schiphol International, the international arm of Schiphol Group, which is a Dutch company that owns Amsterdam Airport Schiphol, Rotterdam The Hague Airport, and Lelystad Airport. It also owns 51% of Eindhoven Airport and 19% of Brisbane Airport in addition to its ownership in JFKIAT. Lehman JFK LLC is an indirect and wholly owned subsidiary of Lehman Brother Holdings Inc., which went bankrupt in 2008. Lehman JFK LLC is not in bankruptcy.

Among the bidders, JFKIAT was judged the best in all categories as its proposal best demonstrated an understanding of what the Port Authority was trying to accomplish. In addition, JFKIAT was the only bidder that proposed to make an unconditional equity contribution (\$15 million). The Port Authority's willingness to provide access to the tax-exempt bond market on behalf of the developers and the associated lower cost of capital dis-incentivized a large equity investment.

In May 1996—10 months following the issuance of the RFQ—a memorandum of understanding was signed between the Port Authority and JFKIAT. JFKIAT initiated a due diligence process thereafter, engaging outside consultants to audit financial and operational plans and to conduct legal and regulatory reviews. At the conclusion of the due diligence process, JFKIAT refined its plans for the development and operation of the facility. JFKIAT also continued to develop all construction documents and plans at its own risk (costing \$33 million) before closing.

The lease between JFKIAT and the Port Authority for the operation of the IAB and the construction and operation of Terminal 4 was executed in May 1997 shortly after the closing of the special facility bonds issued to fund the project.

### **H.3.5 Stakeholder Interests**

**Labor.** The Port Authority employed approximately 230 people at the IAB prior to the Terminal 4 project, which included operations staff, customer-service staff, and skycaps. The Port Authority required JFKIAT to interview existing staff for possible employment, but JFKIAT was not contractually obligated to employ any staff. The Port Authority guaranteed jobs in other facilities to those not absorbed by JFKIAT and required JFKIAT to include \$4 million in project costs for the Port Authority's costs in realigning the IAB staff, which were mostly early retirement benefits. Labor interests included:

- Ensuring no decrease in salaries and benefits
- Not relinquishing years-of-service credited towards pension requirements
- Maintaining the stability and protections otherwise provided by government jobs.

In the end, JFKIAT contracted most services out to third parties in order to realize operating expense efficiencies and the expertise of specialized firms. A number of the Port Authority employees were hired by these third party contractors and many skycaps all went to work for a concessionaire.

**Schiphol (JFKIAT partner).** As the operator of one of Europe's busiest connecting hubs, Amsterdam Schiphol Airport, along with other airports, Schiphol had many years of experience in developing, managing, and operating airports. Anticipating the project to be the first of many in the United States, Schiphol's main interest in the Terminal 4 redevelopment was to gain U.S. experience that would position the company well for similar opportunities in the future. When negotiating the terms of the Terminal 4 expansion project, Schiphol also sought to establish good relationships with Delta, the transatlantic joint-venture and SkyTeam alliance partner with its primary tenant in Amsterdam, Air France-KLM.

**LCOR (JFKIAT partner).** LCOR had broad experience in public-private real estate partnerships, mainly government office buildings, and had built relationships with the Port Authority through a concession redevelopment project at the World Trade Center. Although prior to JFKIAT, LCOR

did not have any experience in the airport industry, it believed that the industry was primed for private sector involvement and that the industry represented a substantial growth opportunity. Like Schiphol, LCOR believed that the Terminal 4 project would provide high-profile experience that could be marketed in the future to other airports. Moreover, LCOR believed that the investment had minimal downside risk, on the basis that Terminal 4 would be the largest international terminal at a constrained airport serving the nation's largest city, and that any risk was spread among a diverse base of airline tenants. In this sense, LCOR viewed the terminal as a developer would view a spec office building in a strong real estate market.

After the project was completed, no opportunities for similar participation at other U.S. airports materialized and LCOR's interests became more financial in nature. The strong political support for the Terminal 4 expansion project resulted in pressure to extend to Delta preferential lease terms providing for cost-recovery rates and charges. Believing that the nature of the business opportunity would change, LCOR sold its ownership stake to Schiphol in April 2010.

***Lehman (JFKIAT partner).*** Initially Lehman Brothers was on the team to be the managing underwriter for the original \$934.1 million special project financing, but joined as equity partner after financing JFKIAT's predevelopment costs (totaling \$33 million). Lehman generally acted as a passive partner in JFKIAT, ceding development and operational responsibilities to Schiphol and LCOR. The 2008 financial crisis resulted in the bankruptcy of Lehman Brothers and a desire to exit the partnership. The negotiations for the Terminal 4 expansion project provided an opportunity for Lehman to sell its stake to Schiphol in April 2010.

***Airlines.*** The IAB had historically been served by a large number of foreign-flag airlines. While no single airline had a dominant share of passenger traffic at the IAB, 14 of approximately 45 airlines using the IAB maintained exclusive use leases in 1996 as a legacy of the era in which the facility was constructed. New entrant and other airlines not having such leases were therefore required to negotiate with lessee airlines; as such, their operational needs were typically given lower priority than those of the lessee airlines. Exclusive use leasing arrangements also created operational inefficiencies because gate, ticket-counter, and other space could not easily be shared among airlines operating at different periods of the day. The leasing arrangements at the IAB were by no means different from the arrangements at other terminals, which were generally operated by a single airline or small group of airlines, also requiring new-entrant and smaller airlines to negotiate with lessee airlines for accommodation.

Airline interests in the redevelopment of Terminal 4 were divergent, with lessee airlines generally preferring the rights afforded to them by exclusive-use leases and the non-lessee airlines generally preferring common-use leasing arrangements. Although all of the other unit terminals at JFK were developed and are operated by one or more airlines, no airline group proposed on the Terminal 4 redevelopment, reflecting the magnitude of the development cost and the lack of an anchor airline. Notwithstanding the divergent interests, airlines did have the following interests in common:

- Minimizing the disruption of IAB operations during the construction of Terminal 4
- Replacing the aging IAB with an operationally efficient terminal capable of accommodating forecast demand
- Having certainty with regard to the availability of gate and other facilities for their operations



- Minimizing increases in rates and charges
- Ensuring levels remained competitive with other JFK terminals
- Having the ability to enter into agreements whereby preferential rights such as gate assignments and lower rates and charges could be obtained in exchange for guaranteed activity levels
- Improving customer service and the passenger experience

**USDOT and FAA.** Involvement of the USDOT and FAA during the project was limited, with their primary interests being to ensure that the parties complied with relevant legislation, regulations, and policies. Chief among these were compliance with grant assurances, environmental regulations, and the rates and charges policy. Passenger facility charges (PFCs) were not used to fund the project so related regulations did not apply.

In January 1997, the FAA provided a categorical exemption from the requirement for an environmental assessment and approved an updated airport layout plan including the redeveloped terminal. In March 1997, the FAA consented to the demolition of the IAB, subject to the requirement that grant-funded facilities in the IAB were replaced with “like or superior” facilities.

Federal rates and charges policy requires that rates and charges levied on airlines for services and facilities at U.S. airports be “fair and reasonable” and that airlines cannot be subjected to “unjust discrimination” in fees and operating conditions, unless otherwise agreed to by the airline. Any airline has the right to challenge to the DOT a rates-and-charges regime that it believes does not meet these requirements.

In the official statement for the 1997 special project financing, JFKIAT stated its intention to use a market-pricing approach for rates and charges and to charge differential rates in peak periods. It also stated its belief that the proposed pricing structure complied with rates and charges policy because:

- Such an approach was used at airline-operated terminals at JFK
- Competition among terminals at JFK and Newark would keep rates constrained
- Airlines would have the option to use other terminals at JFK or Newark if they did not agree with the JFKIAT approach
- Each class of airline would be subject to the same rates and charges, with differential rates being charged commensurate with the differing financial and contractual commitments made by each class

While it was reported that one airline was unhappy with the level of the charges imposed and pursued informal lobbying of the Port Authority and state government officials, as of November 2010, no challenges have been filed with the USDOT.

### **H.3.6 Business Terms and Project Financing**

JFKIAT entered into a lease with the Port Authority that was effective May 13, 1997, shortly after the financial closing of the special project bonds on April 25, 1997. The lease term was to expire on

the earlier of the date (1) 25 years after the date of beneficial occupancy of the new facility, or (2) the day prior to the date on which the Port Authority's lease with the City of New York for JFK expired ("City Lease"). The lease required JFKIAT to complete construction of the terminal by May 12, 2002, however, significant financial penalties kicked in if not finished by May 2001. At the time of lease execution, the City Lease was to expire in 2015; however in 2004, the City Lease was extended through 2050. The JFKIAT lease provided for accelerated amortization of principal in the case that the City Lease was not extended. With the extension of the City Lease, the JFKIAT lease for Terminal 4 was amended to expire on May 8, 2026.

Under the lease, the Port Authority covenanted that as long as JFKIAT was operating a 24-hour FIS facility at Terminal 4, it would not construct or operate itself, or permit another non-airline operator to construct or operate, a FIS station at the Airport through May 13, 2026, unless the additional FIS station was necessary to comply with federal requirements or unless the number of passengers using Terminal 4's FIS station exceeded its agreed-upon design capacity. JFKIAT believes that Terminal 4 has benefitted, and may continue to benefit, from this "Restrictive Covenant."

Under the terms of the lease with the Port Authority, JFKIAT is obligated to make rental payments sufficient to pay debt service on the special facility bonds, pay certain operation and maintenance expenses and ground rent to the Port Authority, and to make certain other payments and distributions from revenues available after the payment of debt service. Revenues consist of airline payments (passenger terminal charges, utility recovery charges, exclusive airline space rentals, aircraft parking fees, and ground handling concession fees), terminal concession privilege fees, and tenant parking fees. Revenues generated from airline users of Terminal 4 account for about 85-90% of total Terminal 4 revenues.

In April 1997, the Port Authority issued \$934.1 million in special project bonds to finance construction by JFKIAT of the new Terminal 4, which consisted of demolishing the IAB and constructing the new Terminal 4, including a terminal building, terminal frontage roadway, and aircraft parking ramp. The bonds are secured by rental payments (i.e., amounts required to pay debt service on the bonds), the pledge of a leasehold mortgage, and certain other pledged assets of JFKIAT, and are not a general obligation of the Port Authority. JFKIAT makes facility rental payments from its net revenues (revenues less operating and maintenance expenses and ground rental to the Port Authority). The 1997 bonds received investment grade ratings of BBB+ by Standard & Poor's, A by Fitch, and BAA2 by Moody's. The bonds were insured by MBIA and oversubscribed by a factor of three.

In connection with the \$172 million in completion financing provided by the Port Authority to JFKIAT, a lease amendment was executed in August 2001. Although JFKIAT initially asked the Port Authority to issue additional bonds to fund cost overruns, the Port Authority offered to provide a subordinate loan to expedite the financing and minimize the complexities of dealing with the various financial parties. The Port Authority also wanted to protect its landlord position in the "waterfall" from another creditor and improve upon the overall economics of the deal for itself. In particular, as a result of this financing and the associated amendment to the lease, the Port Authority retained a majority of the distributions after the payment of operating expenses, ground rent (to the Port Authority), debt service, reserve deposits, and the terminal and retail management fees to JFKIAT. In return, JFKIAT received a higher terminal management fee and higher retail management fee. Subsequent lease amendments were executed that modified the terms for the completion financing. As a result, financial returns to JFKIAT consist primarily of its share of

distributions after payment of operating expenses, ground rent, debt service, reserve deposits plus terminal and retail management fees.

Unlike the cost-recovery pricing methodology used at most U.S. airports, JFKIAT imposes differential pricing that recognizes the value to airlines of access to the facilities during peak periods and the value to JFKIAT of longer term, fixed lease commitments. These rates are generally set to reflect market-based competitive rates for rents and fees. Airlines have the option of entering into agreements of various terms (as short as 30 days and as long as 10 years) with JFKIAT, with those airlines that guarantee a minimum passenger volume for a longer period of time generally being charged lower rates. The lease requires JFKIAT to submit an annual strategic plan to the Port Authority, the process of which includes a joint review of the proposed pricing structure. Any agreement between JFKIAT and an airline with a term of more than 7 years requires written consent from the Port Authority.

In connection with the 2010 Expansion Project, Delta signed a 30-year “Anchor Tenant Agreement” with JFKIAT providing for the preferential lease of up to 16 loading-bridge-equipped gates. Delta’s terminal use fees will generally be calculated using cost-recovery principles, as opposed to the traditional market-pricing approach used to date. A second series of special project bonds was issued in December 2010 to finance the 2010 Expansion Project.

In consideration for the 2010 Expansion Project, the Port Authority extended the Terminal 4 lease through the earlier of 30 years from the date of beneficial occupancy of the expanded terminal or December 2043. The amended lease also provides for an independent contractor to conduct a study of the physical condition of Terminal 4 prior to May 13, 2026 (the original expiration date), to identify any maintenance or other capital repairs that are necessary or appropriate for maintaining the requisite level of service at Terminal 4, and its competitive position as a passenger terminal, over the balance of the term of the Lease. JFKIAT will be obligated to undertake any such identified refurbishments and cooperate with the Port Authority to secure associated financing, including the possible issuance of additional Terminal 4 bonds.

### **H.3.7 Consequences**

***Development Experience.*** Terminal 4 was developed over the four-year period between 1997 and 2001, during which portions of the IAB remained in operation. As part of the competitive bidding process, JFKIAT developed a construction plan and further modified that plan as a result of the due diligence process. The plan included a construction staging schedule intended to minimize disruption to passengers and tenants. The original schedule projected date of beneficial occupancy of December 15, 2000.

As the developer of Terminal 4, JFKIAT engaged the following participants in the design and construction of the facility:

<b>Contractor</b>	Morse Diesel International, Inc.
<b>Program manager</b>	Fluor Daniel, Inc.
<b>Design team</b>	TAMS Consultants, Inc. Skidmore, Owings & Merrill Ove Arup & Partners Communication Arts Inc. Graphics Interior Design International

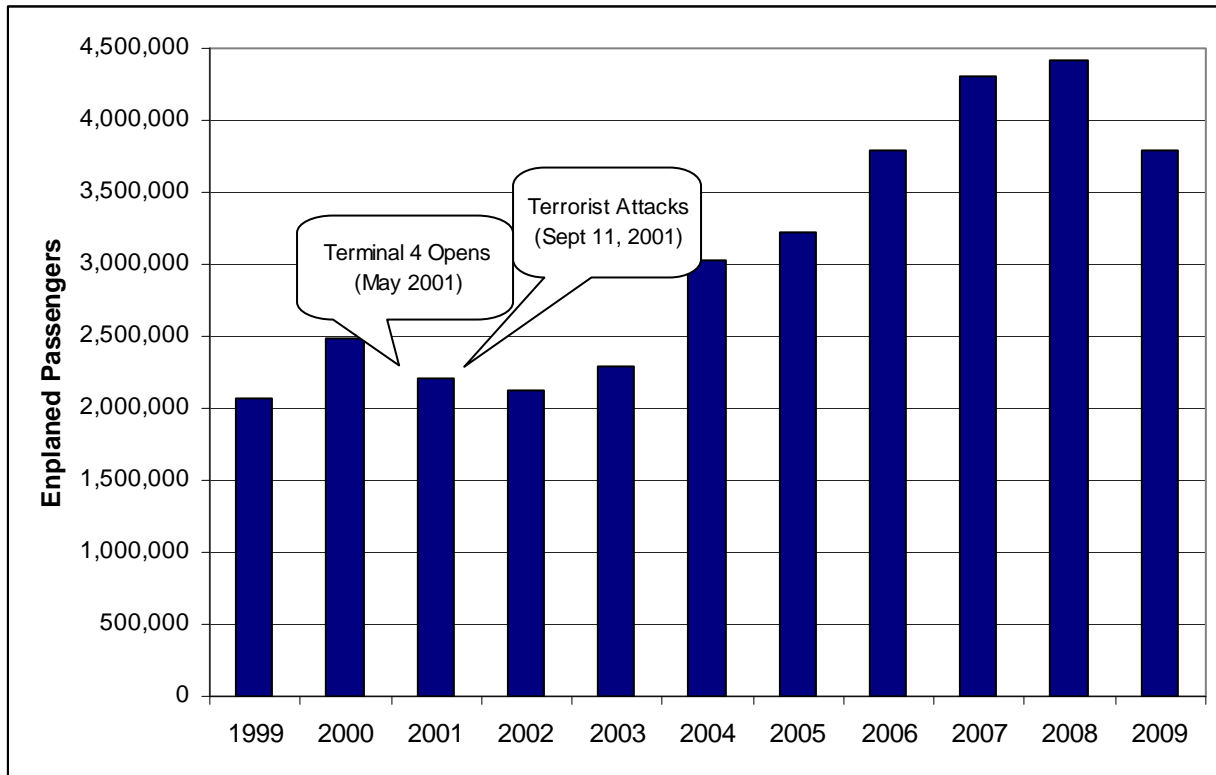
At financial closing of the special facility bonds, JFKIAT intended to enter into a guaranteed maximum price contract with Morse Diesel. JFKIAT was unable to enter into such contract due to the limited set of construction documents. The project was completed in May 2001 at a construction cost approximately 20% over the budgeted amount. (The final cost of construction was approximately \$1,069 million, compared to an original estimate in 1997 of \$876 million.) JFKIAT attributed the cost overruns to (1) staging costs, (2) unforeseen site conditions, (3) subcontractor disputes, and (4) architectural design features. JFKIAT was also highly motivated to complete the project by May 8, 2001 (the deadline in the lease) because upon the date of beneficial occupancy it could increase the per-passenger rates and realize significant increased revenues as well as avoid paying a significant penalty under the lease if not finished by then. Due to the loss of time dealing with the existing conditions, it cost more to accelerate the later stages of construction.

The cost overruns required that JFKIAT obtain completion financing, which was provided by the Port Authority through a \$172 million subordinate loan as noted above.

***Operational Experience.*** Since its completion in 2001, Terminal 4 has operated successfully, substantially improving operational efficiency compared with the IAB -- in large part due to the new state-of-the-art building -- and serving many airline tenants with diverse interests. Its operational and pricing structure has enabled it to respond more proactively to changes in the airline industry. As a full common use terminal, Terminal 4 was able to accommodate numerous airlines that operate at relatively low frequencies, thereby increasing utilization versus the IAB.

Terminal 4 has also captured an increased share of passenger traffic at JFK, with its 13.2% share of passengers enplaned in 1999 increasing to 19.9% in 2009. During the 10-year period, enplaned passengers at Terminal 4 increased an average of 8.2% per year, compared with an annual average of 3.9% for JFK as a whole. JFKIAT attributes this increase to the terminal's increased capacity and ability to accommodate new entrants. The low frequency airlines that are not affiliated with a major airline alliance generally prefer operating from Terminal 4 over other JFK terminals because it is not operated by an airline. While priority use rights are conferred to some contracting airlines, airlines operating from Terminal 4 have greater certainty that their flights will not be "bumped" due to the scheduling decisions of a landlord airline. Airlines also realize efficiencies in the sense that they can separately negotiate operating agreements with JFKIAT with provisions such as term and guaranteed traffic levels tailored to their needs, as opposed to negotiating a under less flexible terms with the airlines operating the other unit terminals.

Figure H.2. Historical Terminal 4 Enplaned Passengers



Source: Preliminary Official Statement, the Port Authority of New York and New Jersey Special Project Bonds, Series 8, JFK International Air Terminal LLC Project, November 15, 2010.

JFKIAT sets airline rates and charges to reflect market demand for the facilities it offers rather than use cost-recovery formulas like most U.S. airports. To enhance facility utilization, JFKIAT offers lower passenger charges for off-peak activity. To attract long-term occupancy, JFKIAT offers lower rates for signatory commitment. The key determinants of differential pricing are:

- **Contract Status:** Airlines with a longer lease term commitment are offered lower unit charges, assigned higher priority for access to facilities, and permitted certain handling rights. Airlines with no agreement are assessed a premium.
- **Off-Peak Operations:** Airlines are offered discounted charges for off-peak operations to encourage efficient use of facilities and to compete with similar pricing offered by other terminals during periods of low terminal operations.
- **Volume Guarantees:** Airlines committing to minimum annual guaranteed payments are eligible for preferred contract status.

Most of the airline space in Terminal 4 is nonexclusive, with preference for use based on airline contract status. Signatory airlines have preference in the use of space relative to contract airlines, which, in turn, have preference relative to independent airlines.

Differential rates ranging from \$15 to \$60 per enplaned passenger are set for peak and non-peak periods and international and domestic use. JFKIAT initially used rates charged for the use of Terminal 1 (an 11-gate, airline-consortium-operated, common-use international terminal opened in 1998) as benchmarks in setting Terminal 4 use fees.

The peak-pricing approach used by JFKIAT provided some relief for airlines suffering financially as a result of the September 11, 2001 terrorist attacks, 2008 fuel crisis, and other industry turmoil. While contracting airlines were generally held to the terms of their agreements with JFKIAT, including provisions for guaranteed passenger volumes, some airlines were able to realize savings by moving flights from peak periods to “shoulder” off-peak periods without sacrificing the scope of service provided from JFK. Other airlines having month-to-month agreements were able to cancel service without financial penalty. While the September 11, 2001 terrorist attacks resulted in forecast passenger levels not being met after the terminal opened, activity recovered quickly enough such that by 2004 the expected passenger levels materialized.

Terminal 4 was designed to incorporate many of the concession planning and design principles used in the successful concessions at Amsterdam Schiphol Airport and certain other European airports. The terminal concession program provides approximately 11,000 square feet of duty free, 31,500 square feet of retail, and 17,500 square feet of food and beverage for a total of 60,000 square feet (not including storage and service areas).

Every passenger must pass through the retail concourse on the way to their gates. Unlike the old IAB and most other U.S. airports, all retail shops and restaurants were initially located prior to security to enable well-wishers and meeters/greeters to use the facilities. Because airlines require international passengers to check-in 2 hours in advance of their flight time, there is ample opportunity for shopping and dining prior to a lengthy international flight. The retail concourse provides the only substantial seating area prior to security screening, and serves as the principal waiting area for passengers until departure gates are posted to encourage maximum passenger dwell times.

Internal forecasts of concession revenues that were prepared during the planning process were not realized. JFKIAT attributes this shortcoming primarily to the (1) significantly worse-than-expected sales of duty free goods after the abolition of duty free sales for intra-European Union traffic in July 1999, (2) traffic declines after September 11, and (3) passenger behavior changes after September 11 due to longer security checkpoint times. With the increased security measures put into place following the September 11, 2001 terrorist attacks, passenger behavior has changed with reduced pre-security dwell times as the majority of passengers proceed directly to their departure gates after check-in. However, most concession outlets were located pre-security. This problem was partially addressed by adding concession outlets post security and will be addressed in a more comprehensive manner in the 2010 Expansion Project by consolidating and moving the security checkpoints before the main concession courtyard.

Table 10.7 summarizes recent historical airline and nonairline revenues per passenger for Terminal 4 as compared to the first year of operation by JFKIAT.

**Table H.7. Historical Airline and Nonairline Revenues per Enplaned Passenger**

	1997	2006	2007	2008	2009
Enplaned passengers (000)	3,239	3,789	4,312	4,415	4,552
Airline revenues (000)	\$100,463*	\$140,821	\$163,183	\$173,342	\$186,459
Per enplaned passenger	\$31.02	\$37.19	\$37.84	\$39.26	\$40.96
Nonairline revenues (000)	\$17,403*	\$26,840	\$32,936	\$34,670	\$31,395
Per enplaned passenger	\$5.37	\$7.08	\$7.64	\$7.85	\$6.90
* As estimated in April 1997. Sources: <i>Preliminary Official Statement, the Port Authority of New York and New Jersey Special Project Bonds, Series 6, JFK International Air Terminal LLC Project</i> , April 25, 1997 and <i>Preliminary Official Statement, the Port Authority of New York and New Jersey Special Project Bonds, Series 8, JFK International Air Terminal LLC Project</i> , November 15, 2010.					

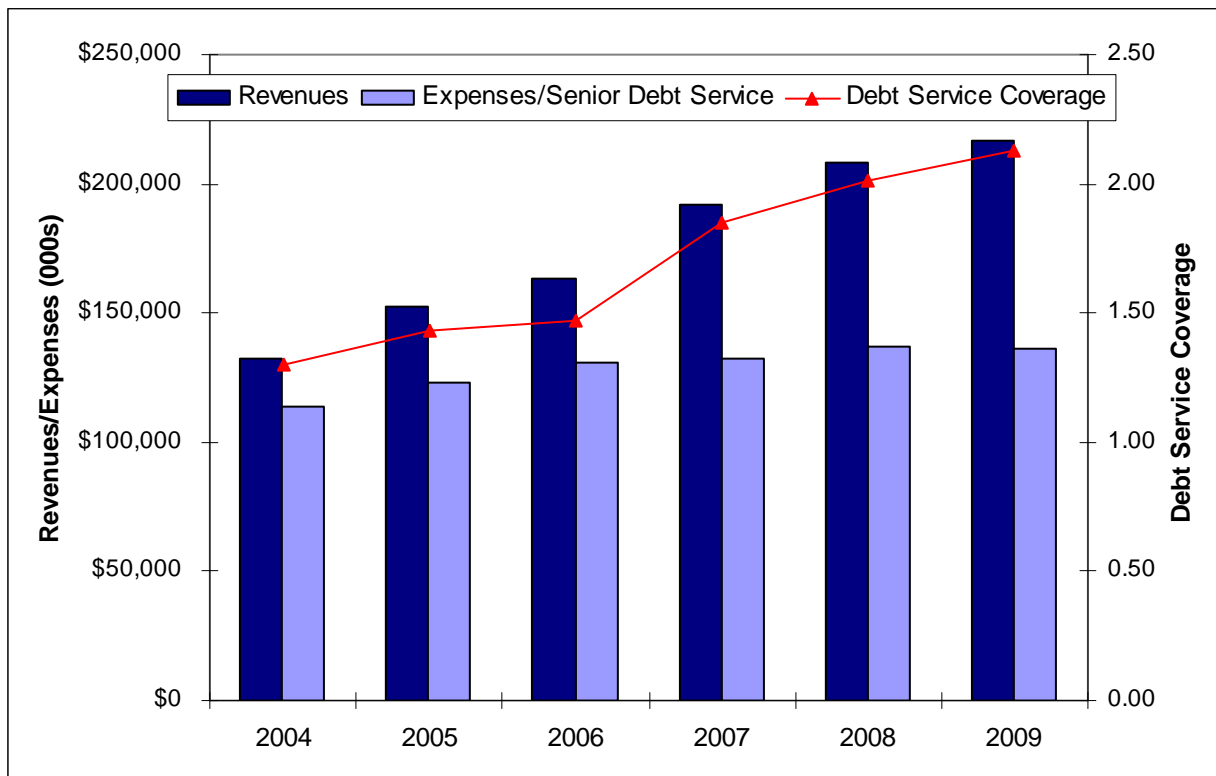
JFKIAT has realized savings in operating and maintenance expenses by reducing personnel, outsourcing functions (major maintenance, janitorial and custodial, security, etc.), and introducing efficient work processes. By outsourcing certain services that had traditionally been provided by the Port Authority, JFKIAT was able to reduce in-house headcount by almost 75% (from approximately 230 to 60). Other operating efficiencies such as a building automation system were built into the energy-efficient design of the new terminal. The ability to operate outside of Port Authority procurement procedures, employment pay scales and contracts, and political influence allowed JFKIAT in many cases to obtain more advantageous contractual terms than could have been obtained by the Port Authority. In the end, JFKIAT had a strong incentive to maximize passenger throughput, “run a tight ship” and “sweat the asset,” as it would retain any excess revenues and operational savings. Unlike the Port Authority, JFKIAT had to pay sales taxes to New York City and the State of New York for outsourced labor and certain other expenses.

Under the prior residual-lease approach for the IAB, the Port Authority was not incentivized to control operating costs, as all operating costs were passed on to airline tenants. Operating expenses for Terminal 4 in 2005 (3 years after completion) were approximately \$42 million compared to \$54 million in 1997 for the IAB despite an approximate 7% increase in building square footage.

Terminal 4, which opened in May 2001, underperformed in the first two years of operations (2002-2003), reflecting the difficult operating environment in the early 2000s. The events of September 11, weak economic conditions, outbreak of Severe Acute Respiratory Syndrome (SARS), and Iraq war had a severe effect international traffic in the U.S. and at JFK. These unforeseen external factors significantly affected the project's operating performance. For example, total international passengers at JFK declined 18% between 2000 and 2003. However, since that time Terminal 4 has benefited from a strong recovery in passenger volumes, an associated increase in revenues, and the extension of the debt amortization period for senior and subordinate debt (from 2015 to 2025) as a result of the extension of the City Lease with the Port Authority in 2004.

As a result of the traffic declines in 2002 and 2003, debt service coverage on senior lien debt was 1.00x for both years, which was below the 1.25x rate covenant. In addition JFKIAT used \$1.5 million in completion debt proceeds to pay a portion of debt service in 2002. Under the financing documents, the rate covenant violation would have been an event of default, but the bond insurer (acting behalf of bondholders) agreed to waive the covenant requirement through 2008 while a recovery plan was implemented. As shown in Figure H.3 below, debt service coverage improved to 1.30x in 2004, reflecting a 33% increase in passengers as JFKIAT held operating expenses flat. With the subsequent strong growth in passenger levels, debt serve coverage has increased consistently since 2004.

**Figure H.3. Historical Revenues, Expenses, and Debt Service Coverage  
(in thousands, except debt service coverage)**



Sources: Standard & Poor's Ratings Services, Port Authority of New York and New Jersey John F. Kennedy International Air Terminal LLC; Ports/Port Authorities, November 10, 2009, and *Preliminary Official Statement, the Port Authority of New York and New Jersey Special Project Bonds, Series 8, JFK International Air Terminal LLC Project*, November 15, 2010.

**2010 Expansion Project.** In 2007, the Port Authority, JFKIAT, and Delta began negotiations regarding the expansion of Terminal 4 to replace Delta's aging facilities at Terminal 3. (Similar redevelopment had been considered before, but plans were abandoned following the September 11 terrorist attacks.) As best described by Bill DeCota in 2008, the Port Authority's Aviation Director at that time:

*"In the old days, we built all these small terminals, and today we are building these mega-terminals with a lot of common space used by many carriers. It's the best way to maximize the efficiency of space. It will be a very*



*adaptable terminal to reflect the change that's happening in airports.”<sup>10</sup>*

In August 2010, the parties announced plans for a \$660 million construction cost expansion, to include 9 additional loading-bridge-equipped gates and improvements to the central terminal, the creation of a new domestic baggage claim hall on the east side of the building, and the installation of an in-line baggage screening system. In consideration for the 2010 Expansion Project, the Port Authority extended the Terminal 4 lease through the earlier of 30 years from the Date of Beneficial Occupancy of the expanded terminal or December 2043.

The project will be financed with additional special project bonds on par with the 1997 special project bonds.

Under the terms of an agreement between JFKIAT and Delta, Delta will have preferential-use rights to the 9 new gates and up to 7 existing loading-bridge equipped gates and will pay rates and charges calculated according to cost-recovery principles (as opposed to the market-pricing approach). In addition, Delta would manage the 2010 Expansion Project design and construction.

In connection with the project, Schiphol acquired the ownership stakes of LCOR and Lehman in April 2010. In anticipation of the 2010 Expansion Project in April 2010, the Port Authority consented to Delta's acquisition of an indirect interest in JFKIAT and Delta paid the Port Authority a \$9.4 million transfer fee. Delta's indirect ownership interest in JFKIAT gives it certain consultation and consent rights with respect to the management and operation of Terminal 4.

The 2010 Expansion Project is expected to be completed in May 2013. At that time, Terminal 3 will be demolished and replaced with an apron capable of accommodating up to 16 aircraft. Subject to obtaining the requisite FAA approvals, the demolition of Terminal 3 and apron redevelopment is to be financed with PFCs contributed by the Port Authority. The project is expected to be fully completed in July 2015.

On November 4, 2010, the JFKIAT bonds were downgraded to below investment grade status by Fitch. According to Fitch:

*“Fitch views the construction risk and Delta counterparty risk as near-term rating constraints during the project's construction phase, considering cost estimates are not currently locked in due to the design-bid-build project management approach.”<sup>11</sup>*

The downgrade to BB from BBB came in anticipation of the planned sale of \$857 million bonds later in November for the Delta expansion.

With the 2010 Expansion Project and Delta's cost recovery rates, more than half of Terminal 4 has morphed into another airline-financed terminal like the others at JFK.

### **H.3.8 Lessons Learned**

As noted earlier, Terminal 4 is generally recognized in the industry as a successful example of

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<sup>10</sup> Bent Wilson, *Port Authority Reviews Future Of JFK Terminals 2, 3 And 4*, Aviation Daily, July 28, 2008.

<sup>11</sup> *Fitch Rates JFK Int'l Terminal Project \$825MM Series 8 Bonds 'BB'; Dwngrs Outstanding Bonds to 'BB'*, Fitch Ratings, November 3, 2010.

nonairline, private sector participation in terminal development and operation. The project did not require any federal or state legislation such as the Airport Privatization Pilot Program to be implemented. There has not been a project of comparable magnitude completed in the U.S. since Terminal 4 opened in 2001. As a reflection of its general satisfaction with the conceptual model, the Port Authority is considering, among other options, using certain aspects of the Terminal 4 model in connection with a terminal expansion at Newark and the planned redevelopment of the central terminal building at LaGuardia Airport.

The project was a first-of-its-kind experiment and as a result has provided some lessons learned by the stakeholders, including:

- The ability to access tax-exempt financing made the Terminal 4 redevelopment viable. LCOR estimated the tax-exempt financing provided a roughly 30% discount on private financing.
- Although the Port Authority sought to attract private equity in the project, ultimately its access to the tax-exempt bond market on behalf of the developers and the associated lower cost of capital dis-incentivized a large equity investment that would have required higher returns for the developer. JFKIAT's contribution of \$15 million was motivated by the Port Authority's desire that the consortium have "skin in the game."
- JFKIAT was able to successfully experiment with market-based pricing, which very few public airports use. In particular, after the downturn in traffic resulting from September 11 and SARS, as a private entity JFKIAT was able to negotiate special pricing with airlines that could not have been accomplished under typical public procurement rules.
- Normally in the U.S., airport terminals are subsidized by parking and rental car revenues given the large amount of public space. In this case, Terminal 4 had to stand financially on its own without these subsidies. As a result, the JFKIAT model is not universally transferable to other U.S. airports. It worked at JFK because of the inter-airport terminal capacity limitations, high user rate levels for competing facilities, high percentage of international traffic (which can support substantially higher charges), and ability to charge fixed, profit-based pricing to use the terminal. Therefore, the model may not be readily adaptable in other locations without some form of subsidy from other nonairline revenues, particularly parking and rental car revenues. This model is best suited to application at large, multi-airline airports with unit terminals.
- A frequently cited rationale for involving the private sector in facility development is to obtain construction and program management expertise and therefore mitigate the risk of cost overruns and schedule delays. While Terminal 4 was completed on-schedule, the final project cost was about 20% higher than the budgeted cost. One of the complexities in its development was the requirement to remain operational during construction.
- Because this transaction is essentially a cash flow deal -- meaning that all the value is derived from the residual cash flow -- both the Port Authority and JFKIAT's interests were well aligned because both benefited from the cash flow. JFKIAT was highly motivated to complete the project as quickly as possible, much like a traditional real estate developer.

- Risk avoidance in general is an overarching rationale for privatization. In the case of Terminal 4, however, one might question the magnitude of the “real” risk that was actually assumed by JFKIAT. JFKIAT only invested \$15 million in equity, but did invest a great deal of time and effort in the venture as well as risk \$33 million in predevelopment expenditures. Regardless of the financial viability of the project, the Port Authority in the end must serve the public interest of ensuring the busiest international terminal in the region remains operational. JFKIAT, on the other hand, could “walk away” if the operation in its judgment became unfeasible. Ultimately the main risk for the project rested with the bond insurer and bondholders not JFKIAT or the Port Authority.
- Unlike toll road projects where the term of the transaction is usually 50 years or more, the relatively short term for this transaction (initially 15 years) limited the amount of equity that could reasonably be bid. Given the limited amount of equity, the return on investment is quite large.
- The early years of the lease were the most vulnerable and the Port Authority played an important role in mitigating risk in these early years. When JFKIAT fell upon hard times after September 11 and SARS, in conjunction with the accelerated debt amortization period (prior to the extension of the City Lease) and the need for completion financing, the Port Authority stepped up to assist JFKIAT by amending the lease agreement and providing subordinate financing. Although JFKIAT felt it could access financing from the bond market, the financing provided by the Port Authority provided a “win-win” solution for both parties as JFKIAT had a credit rating at the time that was below investment grade. The level of cooperation provided by the Port Authority to JFKIAT demonstrated its commitment to the facility and desire for its success.
- The long-term lease meant that control over the site and the flexibility to respond to changing market conditions was relinquished by the Port Authority. While this factor was not important in the early years of operation, it became a more important consideration later on. From a customer service perspective, replacing Terminal 3 was a top priority for the Port Authority, and expanding Terminal 4 was the logical and most economically viable solution. However, the Port Authority only had indirect influence on the outcome of negotiations between Delta and JFKIAT, two parties with competing financial interests. In the end, Delta’s interest to pay cost-recovery rates and Schiphol’s interest to maintain a good relationship with Delta and its SkyTeam partners were met with Schiphol’s purchase of LCOR’s and Lehman’s stakes in JFKIAT. Although short-term lease may be more appropriate to protect against industry uncertainty, a shorter term would be less attractive to private investors and harder to secure financing.
- Key to the success of the Terminal 4 project was the fact that there was no “anchor tenant,” whose needs were driving facility design and development at the expense of other tenants. With no airline having a large share of traffic at the terminal, any organized opposition to the project was difficult. These dynamics have changed to some degree as a result of the Terminal 4 expansion project and Delta’s preferential-lease status.
- The project has also been successful because it is one of several terminals at JFK that must compete for traffic with other terminals. This competition works to keep rates from becoming unreasonable and to incentivize JFKIAT to run an efficient facility with high

customer service standards. Competition between terminals minimizes the need for more heavy-handed regulation, as JFKIAT must compete for airline customers.

- JFKIAT also has a strong incentive to maximize the passenger throughput of the terminal based on the per-passenger pricing regime and the associated passenger-related concession revenues. JFKIAT is also incentivized to minimize operating expenses; however, maximizing revenues in a competitive environment requires high service levels so the incentives are well aligned for both the Port Authority and JFKIAT.

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## H.4 Boston Logan Terminal A

### H.4.1 Background

The Massachusetts Port Authority (“Massport”) is a multipurpose agency that owns and operates, among other facilities, Boston-Logan International Airport (“Logan”); Hanscom Field, a general aviation reliever airport; and Worcester Regional Airport. Logan is primarily an origin-destination (O&D) airport and has a diverse mix of carriers. In 2009, the airport accommodated 12,566,797 enplaned passengers of which 87.5% were O&D passengers and no airline accounted for more than 15% of the passenger share.

There are four unit terminals serving commercial passengers at Logan that provide a total of 98 gates:

- Terminal A with 22 gates (initially 18) and 7 regional jet parking positions, which was developed by Delta Air Lines and opened in March 2005
- Terminal B with 36 gates, which opened in 1976 with renovations completed by American Airlines in 1995 and US Airways in 1998 and 2000
- Terminal C with 27 gates, which opened in 1969 with renovations completed by Massport in 1987, United Airlines in 2002, and JetBlue in May 2005
- Terminal E with 13 gates, which opened in 1974 with renovations completed by Massport in 1997, 2002, and August 2008

The original Terminal A opened in 1969 and was sized and configured to accommodate traffic from that era. Eastern Airlines held a long-term lease on the facility that extended from 1969 through late 1994, which gave Eastern primary responsibility for the operation and maintenance of the 14-gate, 200,000 square foot facility. At Eastern’s peak, Terminal A processed over 2 million enplaned passengers per year. Eastern filed for bankruptcy in March 1989 and ceased flying in January 1991. Due to a new inbound access roadway to Logan that was being constructed by the Massachusetts Highway Department as part of the new cross-harbor tunnel (Ted Williams Tunnel) and the associated right of way issues related to the Terminal A site as well as structural problems identified with the building, Massport decided to buy out Eastern’s remaining leasehold interest in the terminal in 1992 and began studying options for its replacement.<sup>12</sup>

In anticipation of the opening of the new Ted Williams Tunnel and the associated land impacts to the airport, Massport embarked on a major \$1 billion redevelopment of Logan called the Logan Modernization Program in the mid 1990s. After operating with the same basic terminal configuration for two decades, Massport identified three terminal development projects at that time – new replacement Terminal A, the US Airways project at Terminal B, and the international gateway project at Terminal E -- to expand terminal capacity from 85 to 98 gates. The Logan Modernization Program also included double-decking the on-airport roadway system, building a new parking garage, making improvements to the existing garage, building elevated and enclosed pedestrian walkways connecting the central garage to unit terminals, and refurbishing the central heating and cooling plants. After studying the potential to upgrade and renovate old Terminal A on an interim

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<sup>12</sup> Not only was the facility undersized, but structural engineering studies at that time concluded that the useful life of the old Terminal A was uncertain and that it would be increasingly costly to maintain the structure.

basis prior to its replacement (as set forth in the long-term development plan), Massport realized it would be best to replace the facility.

#### **H.4.2 Transaction Summary**

With political pressure to privatize Logan and recognizing that the Terminal A project would require significant capital investment, Massport decided in 1996 to explore private sector involvement in the redevelopment of Terminal A. Initially, Massport explored a private developer approach for the replacement terminal, but due to state public bidding laws, and the private developers' requests "to shift risk to the Authority" or for "subsidies" such as a share of rental car commissions, this approach was deemed infeasible. Massport then began negotiations with Delta to develop the new terminal.

New Terminal A was developed under a special facility lease between Massport and Delta. Terminal A opened on March 16, 2005 with 18 jet gates<sup>13</sup> and 7 regional airline parking positions with Delta as the sole tenant. Terminal A includes a main terminal building and a satellite building that are connected by an underground tunnel and moving walkways. The terminal allowed Delta to consolidate all of its operations into one location to provide operational efficiency and room to expand. Delta, Delta Connection, Delta Shuttle, and Delta's subsidiary Song (now defunct) previously operated out of Terminals B and C.

The redevelopment project was largely funded with special facility revenue bonds issued in August 2001, which were secured solely by Delta and insured by Ambac Assurance Corporation ("Ambac"). When the lease was signed on August 16, 2001, the terminal was considered fairly well designed. After the terrorist events of September 11, 2001, Massport and Delta worked together to redesign the terminal to incorporate additional security features and to reduce costs.<sup>14</sup>

Shortly after the opening of new Terminal A, Delta filed for protection under Chapter 11 of the U.S. Bankruptcy Code on September 14, 2005. To assist Delta in its reorganization efforts and to avoid the potential for costly litigation, Massport, with the consent of the bond trustee and Ambac, agreed to restructure the original lease and bond trust agreement. Delta then signed an amended and restated 10-year lease dated July 1, 2006, reducing the number of aircraft gates it leases in Terminal A to 14 and the number of ground loading positions to 5. Massport subsequently leased 4 of the relinquished gates and 2 regional aircraft ground loading positions to Continental Airlines, under a 5-year lease agreement (that expires in November 2012). After Delta and Northwest merged, Delta leased the remaining gates in Terminal A.

Massport is not obligated to make the debt service payments on the Terminal A bonds. If pledged facility rentals and associated reserves are insufficient to make the debt service payments, the payments become the responsibility of Ambac under the terms of the bond insurance agreement.

#### **H.4.3 Privatization Objectives and Motivations**

***Ideological Imperatives.*** When Governor Weld took office in 1991, the state's bond rating was near junk status, unemployment was nearly 10%,<sup>15</sup> and the state had just incurred several

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<sup>13</sup> The gates were subsequently reconfigured to provide 22 jet gates.

<sup>14</sup> Dave Bannard, *Large Capital Projects*, AAAE Airport Magazine, June/July 2010.

<sup>15</sup> Wikipedia, *William Weld*, accessed November 15, 2010.

consecutive budget deficits. Given the state of affairs, Weld was committed to establishing Massachusetts as a leader in privatization and established a “Privatization Support Group” in the Administration and Finance Secretariat. As stated in 1992 by John R. Guardiano, the managing editor of Privatization Watch, a monthly newsletter published by the Reason Foundation:

*"Weld is very much committed to the concept [of privatization] and is intent on actively implementing it...[Weld's effort in Massachusetts] "is the most ambitious attempt ever by any state governor to privatize state assets and service responsibilities."<sup>16</sup>*

Among the various options explored, Weld and his aides tried to assess the potential benefits of selling certain state assets, including Logan. As governor, Weld had responsibility for appointing the 7 members of the Massport Board.<sup>17</sup> Given the political environment, Massport began considering alternatives for private sector participation in its operations. The redevelopment of Terminal A was identified as an attractive opportunity given its significant cost and Massport needed to preserve financing capacity for the Logan Modernization Program as well as its sizable airfield, sound proofing, major maintenance, and the other port facility improvements in its \$3.7 billion FY 1995 – 2005 capital budget.

As noted later, the Port Authority of New York and New Jersey was also considering private sector participation in its operations under a similarly minded state administration.

***Delta's Interests.*** As the largest carrier operating from Logan (in terms of passengers), Delta increased its share of the Logan passenger market from 16% in 1986 to 23% in 1998, when Massport started talking to Delta about Terminal A. Delta wanted to continue to expand its operations at Logan and consolidate all four of its product lines at that time – Delta (mainline domestic and international service), Song (its low fare business unit, which is now defunct), Delta Connection (its regional airline affiliates), and Delta Shuttle (service to New York LaGuardia and Washington National airports) -- in one building. Terminal A was the only site that had enough potential to accommodate all these products in one building. In addition, as the first terminal on the entrance road combined with new state-of-the-art facilities, Delta felt the new terminal would give it a competitive advantage over its competitors at Logan.

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<sup>16</sup> Nation's Business, *The Governor's Massachusetts revolution - William Weld; privatization of state services - Cover Story*, August, 1992

<sup>17</sup> Massport Board members are appointed for 7-year terms, with the term of one member expiring each June 30. Weld served as governor from 1991 – 1997.

### H.4.4 Transaction and Development Timeline

A timeline for the planning, construction, and operation of Terminal A and related material events are as follows:

**Table H.8. Boston Logan Terminal A Privatization Timeline and Related Events**

1992	<ul style="list-style-type: none"> <li>▪ Massport began planning studies for Logan Modernization Program</li> <li>▪ Eastern Airlines rejects its long-term lease of Terminal A in bankruptcy when Massport bought out the remaining interest</li> </ul>
1993	<ul style="list-style-type: none"> <li>▪ Massport studies potential for interim improvements to Terminal A</li> </ul>
1995	<ul style="list-style-type: none"> <li>▪ Construction of Logan Modernization projects began</li> <li>▪ Massport identified its \$3.7 billion FY 1995 -2005 Capital Program</li> </ul>
1996 – 1997	<ul style="list-style-type: none"> <li>▪ Massport studied development approach options for Terminal A</li> <li>▪ Massport issued RFQ for private developer</li> <li>▪ 7 development teams submitted qualifications</li> <li>▪ 5 development teams short-listed</li> <li>▪ Individual meetings with each short-listed team conducted</li> <li>▪ Massport advised teams that major issues were being addressed</li> </ul>
1998	Massport and Delta started discussing development of Terminal A
2001	Design documents developed
August 2001	Lease Agreement signed and Special Facilities Revenue Bonds sold
September 11, 2001	Terrorists attacked U.S. from flights originating at JFK and Logan
Fall 2001	Delta enters into GMP contract for construction services
May 2002	Old Terminal A closed and reconstruction commenced
March 16, 2005	Replacement Terminal A opened
September 14, 2005	Delta filed for Chapter 11 bankruptcy
Late 2005 – June 2006	Massport and Delta negotiated terms of a lease amendment for Terminal A
July 1, 2006	Effective date of Restated and Amended Lease for Terminal A
January 2007	Amended and Restated Lease and other financing documents submitted to bankruptcy court
March 2007	<ul style="list-style-type: none"> <li>▪ Bankruptcy court approves amended lease and financing documents</li> <li>▪ Massport takes back 6 gates and 3 regional parking positions from Delta</li> </ul>
April 2007	Delta exited bankruptcy
November 2007	Massport entered into 5-year lease with Continental for 4 gates and 2 regional parking positions in Terminal A
March 2009	Delta re-leased the remaining gates in Terminal A



#### **H.4.5 Exploration of Private Developer Concept**

In the early 1990s, Massport undertook planning studies that culminated in the identification of the \$1 billion Logan Modernization Program, which commenced in 1995. Although part of the overall redevelopment plans for Logan, the FY 1995-2002 Capital Program budget contemplated that funding to redevelop Terminal A would come from private sources or would be done on a non-recourse basis.<sup>18</sup>

Observing the developments of the Terminal 4 privatization at John F. Kennedy Airport (JFK), Massport decided to explore the potential for private development of Terminal A and issued an RFQ to potential developers in February 1997. Seven teams submitted qualifications and five were short listed. Massport conducted one-on-one focus sessions with the short-listed teams to solicit their input. On the basis of these sessions as well as additional financial and legal due diligence, Massport decided to let the solicitation die. It was decided to abort the process due to legal requirements under the state's procurement laws.

Under Massachusetts public bidding requirements, the "filed sub-bid law" required that various parts of the overall project be bid out to the 17 sub-contractor trades recognized by the state. Under this process, 17 different sets of plans must be drawn up for each trade and bid separately. A week after receiving bids from the designated trades, general contractors, who are ultimately responsible for the project, must submit bids selecting subcontractors from among the bidders. Then the general contractors are chosen on the basis of lowest bid rather than best overall package. As a result, while not technically bound to choose subcontractors with the lowest bids, as a practical matter, the general contractor had little choice.<sup>19</sup>

In order for Massport to offer tax-exempt conduit financing to the developers -- which all bidders said was necessary in the focus sessions -- Massport's legal advisors said it would have had to follow the state's public bidding requirements. Due to the filed sub-bid law, Massport could not make the selection of the developer without the sub bids, which essentially meant that Massport would have to do the design, bid the trades, and bid the general contractor before issuing the conduit debt. Essentially this left the developer with the task of operating the terminal, which defeated the purpose of the private development concept.

Another important factor was that the private developers requested shifting risk to Massport or "subsidies" of parking and rental car revenues, which Massport was not willing to give.

#### **H.4.6 Negotiation of Delta Lease**

Therefore, Massport decided to explore the potential for conduit financing with an airline tenant, which it had used before for the development of Terminal B in 1976 with the South Terminal Corporation (a Massachusetts corporation comprised of airline stockholders) and again in 1996 for US Airways' expansion and redevelopment of Terminal B. Massport's bond counsel advised that although the law was unsettled, the lease agreement with US Airways for the expansion and redevelopment of Terminal B was not a contract for the construction of a public building and therefore was not subject to the state's public competitive bidding requirements.

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<sup>18</sup> Under non-recourse debt, the public entity issuing the bonds on behalf of the tenant is not financially obligated on the debt and the bondholders can look only to the tenant for payment.

<sup>19</sup> James Stergios, *Filed sub-bids stall construction reform*, Boston Herald Op-Eds, September 7, 1999.

Discussions between Massport and Delta commenced in 1998 and culminated in the signing of the Terminal A lease and the issuance of special facility bonds in August 2001. The negotiating process was lengthy and complex, in part to ensure that (1) the terminal's design and construction met Massport's goals and (2) provided Massport with the ongoing flexibility after the terminal's opening to maximize the utilization of the terminal and site.

#### **H.4.7 Business Terms and Project Financing**

The original lease, which was effective August 15, 2001, had an "initial term" and "extension terms." The initial term began on the opening day (March 16, 2005) and lasted 5 years. The extension terms provided for 20 automatic one-year extensions unless Delta was in default under certain provisions of the lease.

Following the substantial completion of the project, responsibility and control for Terminal A was returned to Massport and then Massport leased all the airline space in the terminal to Delta. After the opening of new Terminal A, Massport resumed responsibility for repair and maintenance of structural elements of the building (including roof and building systems) and maintenance of the common areas, the concession space, and gate holdroom areas while Delta was responsible for the maintenance and repair of its premises in the building (excluding the holdrooms) and systems unique to and exclusively serving Delta (e.g., loading bridges).

Under the terms of the original lease, Delta was obligated to:

- Make rental payments sufficient to pay debt service on the special facility bonds ("facilities rent")
- Pay Massport terminal rent calculated by Massport in accordance with a fully compensatory rate model covering all direct and indirect capital and operating cost allocations, including the unamortized cost of the old Terminal A
- Pay Massport an annual "maintenance reserve payment" equal to the airline share of building space times a percentage of the replacement value of the terminal.<sup>20</sup> Massport deposits the maintenance reserve payments into a "Terminal A Maintenance Reserve Fund" that is maintained and held by Massport and to be dispersed by Massport in its discretion for renewal, replacement, or reconstruction of the building or equipment, and for unusual or extraordinary maintenance or repairs, among other uses.

Unlike most special facility-backed terminal financings for airline tenants, this transaction gave Massport considerable leverage to take back facilities under certain circumstances, including:

- ***Preferential Gate Use.*** Delta is subject to Massport's preferential gate use policy with certain exclusions.
- ***Recapture of Underutilized Gates.*** Massport has the right to recapture one or more of the contact gates and certain related areas (including ticketing, baggage, and other operational space needed to conduct airline operations) in the event Delta is not using the

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<sup>20</sup> The percentage of replacement value is equal to 0.5% for the first 10 years, 1.0% for years 11 through 20, and 1.5% for years 21 to 25.

gates at Terminal A to the same extent as the airport's overall domestic gate utilization. In the original lease, Massport had to wait until the 5<sup>th</sup> year to exercise this option. Under the recapture provisions, Massport must either (1) re-let the gates, (2) sublease the gates from Delta, or (3) defease or provide for defeasance of the allocable share of the bonds. Under the re-let and sublease conditions, Massport or the tenant using the space would be required to make monthly payments to the trustee in an amount to cover the allocable share of debt service and an amount equal to Delta's unamortized costs for project-related facilities not financed with bonds.

- **Default Recapture.** The lease also allowed Massport to terminate the lease in the event of a Delta bankruptcy and replace Delta as its tenant.
- **Relocation.** In the 10<sup>th</sup> year of operation, Massport had the right to relocate all of Delta's operations to a qualifying replacement premise on the airport. As a condition to this replacement, either Massport or any replacement tenant(s) that occupied Terminal A was to make monthly payments to the trustee equal to debt service on the bonds and Delta's unamortized costs for project-related facilities not financed with bonds.

Another feature of this special facility financing was that Massport retained control of and the revenues from the Terminal A concessions. (Massport was responsible for paying for the operating expenses associated with the concession space.)

The lease agreement required that the construction contract with the construction manager be in the form of a guaranteed maximum price (GMP) contract supported by payment and performance bonds. Also, the lease required that Delta complete the project within 5 years from the execution of the lease, or August 16, 2006.

In August 2001, Massport issued \$498 million in special facilities revenue bonds to finance construction by Delta of the new Terminal A. The bonds are secured by (1) Delta lease payments, (2) a corporate guaranty provided by Delta, and (3) a 12-month debt service reserve fund, and are not a general obligation of the Port Authority. Delta's lease payments, called "Facilities Rent," was equal to all payments of principal and interest due on the bonds. When the bonds were issued, they received underlying investment-grade-level ratings of 'BBB+' by Standard & Poor's and 'Baa1' by Moody's. The bonds were insured by Ambac.

#### **H.4.8 Project Design and Construction**

The Terminal A project included a replacement terminal of 362,000 square feet, a satellite concourse of 284,000 square feet, and a 25,000 square-foot tunnel connecting the terminal and concourse. In addition, the project included demolition of the old terminal and construction of terminal access roads, aprons, utilities improvements, and an underground fuel system. The project also included a baggage system with inline screening and passenger boarding bridges. The project achieved LEED Certification as the first LEED-certified terminal in the world

Acting as the developer of the project, Delta was responsible for the awarding of contracts and the design, construction, acquisition and installation of the entire Terminal A project, except for extending the fuel hydrant system to the new terminal, which was the responsibility of the airline fuel consortium. Delta was responsible for completing all project elements even if sufficient bond proceeds were not available. Massport provided funds to Delta (or its contractors) for the airfield improvements related to the project (including various aprons, taxiways, and utilities), remediation

of underground fuel contamination (if any) at the project site, a new electrical substation serving Terminal A, a new above-ground passenger walkway connecting new Terminal A to the central garage, and certain roadways adjacent to the terminal.

Delta submitted the schematic design of the Terminal A project to Massport in June 2001, Massport approved the design in July 2001, and construction began in May 2002.

Construction was delivered using the construction manager-at-risk model. The \$500 million Terminal A was completed 30 days ahead of schedule, slightly under budget, and without construction litigation, reflecting the high level documentation and communication between Massport and Delta as well as the incentives and penalties included in the legal documents. According to Massport's deputy chief legal counsel, this accomplishment was achieved as a result of:<sup>21</sup>

- Clear, well-understood agreements, including a development agreement, lease agreement, and GMP contract
- A shared understanding of the goals of the project and familiarity with the underlying contractual documents
- Regular communication among the key stakeholders
- Incentives for achieving goals combined with penalties for failure to perform

Because Delta was responsible for the project's design, Massport and Delta developed design guidelines to document the mutually understood minimum acceptable standards and that also addressed review and approval of plans, specifications, schedule, costs, and change orders. They also specified materials standards, sizing requirements, sustainability, and concession space.

The design guidelines also provided for a design review process. Therefore, even though the terminal was fairly well designed when the lease was executed, after the events of September 11, the project had to undergo a substantial redesign to incorporate additional security features, relocate concessions post security, and reduce costs. The design guidelines were instrumental in expediting the redesign process.

#### **H.4.9 Delta Bankruptcy, Rating Actions, and Renegotiation of Financing Documents**

Six months after the opening of new Terminal A, Delta filed for Chapter 11 bankruptcy. Even before filing for bankruptcy, Delta tried to persuade its SkyTeam Alliance partners -- Northwest and Continental -- to move into Terminal A to help share the expense, but both refused citing the significantly higher rental costs at the new facility as well as the costs to relocate from their current premises. Delta realized that the facility was too large for its operations and was determined to find a way to reduce its obligations.

***True Lease vs. Disguised Financing.*** The legal agreements supporting special facility bond issues determine the rights and security interests of the issuer, the bond trustee, bond insurer, and the airport operator in the event of a bankruptcy by the tenant airline. In very general terms, if the

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<sup>21</sup> Dave Bannard, *Large Capital Projects*, AAAE Airport Magazine, June/July 2010.

airline's payment obligations are evidenced in a loan or in a lease that can be construed as a loan (often called a disguised "financing" lease), then the airline can default on the debt. The lease-versus-loan financing distinction is significant because leases must be assumed or rejected and the debt must be paid when scheduled, whereas disguised financings often become unsecured claims. Debt under a true lease must be repaid if the company in bankruptcy assumes that lease and doesn't want to risk eviction from its facilities.

The Delta lease appeared to fit the parameters of a "true" lease as opposed to a "financing" lease. If the Terminal A agreement had been viewed as a true lease during bankruptcy, Delta would have had the choice of (1) affirming the lease and all its provisions or (2) rejecting the lease for the entire facility. If Delta had rejected the lease, they would not have had space to operate at Logan. Also, Massport would have had to find new tenants for the terminal, which would have caused considerable uncertainty for the timely payment of scheduled debt service through the re-leasing process. Even though Terminal A was needed to meet the then-current demand as well as future passenger levels, Massport's ability to find new tenants at a rental rate sufficient to cover the debt service on the special facilities obligations would have been challenging in the 2005 aviation environment. Massport was not legally required to pay debt service on the bonds, and did not assume the risk of interruptions in rental payments arising from changes in tenants.

**Rating Actions.** As noted above, when the bonds were sold in August 2001, they received underlying investment-grade-level ratings of 'BBB+' by S&P and 'Baa1' by Moody's. Due to the fact that the bonds were secured almost solely by Delta's rental payments<sup>22</sup> and as a result of Delta's deteriorating financial position in 2005, both agencies downgraded the debt. S&P downgraded the bonds to 'BBB-' in March 2005, and in July 2005 stated:

*"We consider the new terminal to be both desirable and important to supporting the existing and future passenger levels at the Logan Airport, though rates are considerably higher at Terminal A than at other Logan terminal facilities. While the likelihood that Delta would immediately discontinue service at Logan upon filing bankruptcy is currently viewed as low, this event would introduce a significant level of uncertainty regarding Massport strategies to maintaining the facilities rent pledged to debt service, as well as Delta's significant longer term commitment to the Boston market and, specifically, to Terminal A. This uncertainty would be inconsistent with an investment-grade-level rating."*<sup>23</sup>

Then one month later (August 2005) S&P downgraded the debt another 5 notches from 'BBB-' to 'B' based on the diminishing credit quality of Delta and kept the rating on CreditWatch with negative implications. S&P further lowered its rating on the bonds to 'CCC-' from 'B' on October 4 after Delta filed for bankruptcy protection (on September 14, 2005).

During bankruptcy Delta filed a motion and received approval to make interest payments due on the bonds through December 2005; however, Delta made it clear that it intended to reserve the right to dispute the proper characterization of facilities rent under the lease agreement.

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<sup>22</sup> The bonds were also secured by the proceeds in the various funds established (including a debt service reserve fund equal to one year's principal and interest) and an unconditional guarantee of Delta Air Lines. However, under Chapter 11, Delta had the option during bankruptcy to reject the lease.

<sup>23</sup> Laura A. Macdonald, *Massachusetts Port Authority's 'BBB-' Special Facility Revenue Bonds Rating On Watch Neg*, Standard & Poor's Ratings Services, July 28, 2005.

*“Following a similar legal strategy used by United Airlines at other U.S. airports, Delta is arguing that the facilities rent payments constitute pre-petition financing obligations that it cannot pay without court approval and should be resolved as claims in the Chapter 11 process.”<sup>24</sup>*

Delta was seeking to renegotiate the lease using the argument that the lease payments are not true lease obligations that must be paid on schedule for it to retain possession of Terminal A. This line of argument had been used successfully by United Airlines during its bankruptcy proceedings to enjoy beneficial occupancy of various facilities financed with special facility debt without paying debt service.

On January 1, 2006, Delta made only \$5.4 million of a \$9 million rental payment due. Ambac, which fully insured the bonds, provided the remaining amount due under the terms of its financial guaranty with Massport. Delta’s decision to withhold \$4 million of the payment was based on its position that it represented a debt owed prior to its Chapter 11 bankruptcy filing in September. Because Delta formally defaulted on the debt, S&P lowered its underlying rating on the bonds 3 more notches to ‘D’ from ‘CCC-’ on January 4, 2006. Moody’s downgraded the debt to Ca at that time and later withdrew its rating in September 2006 following *“Moody’s withdrawal of all ratings of Delta Airlines, Inc. due to the company’s ongoing bankruptcy proceedings and the lack of reliable and consistently available information.”*

It should be noted that Massport’s \$1.1 billion of general revenue bond debt outstanding at that time remained unaffected by these actions on the non-recourse Terminal A bonds. Massport’s debt was rated ‘Aa3’ by Moody’s, ‘AA-’ by S&P, and ‘AA’ by Fitch with a stable outlook.

***Renegotiation of Lease and Financing Documents.*** Delta eventually backed down and entered into negotiation with the various parties. Beginning in late 2005 and extending into mid-2006, Massport, Delta, the bond trustee, and Ambac negotiated amended terms to the Terminal A lease to avoid litigation over Delta’s potential rejection of the lease. Through these negotiations it became clear that Delta did not want or need the full amount of space in Terminal A and wanted to relinquish some of it to Massport. In the end, Delta reduced its leased space in the terminal by approximately one-third and reduced the number of gates under its control from 22 to 14 as well as reserved the flexibility to return some additional space in 2007 and 2011. Delta’s responsibility for the payment of the debt service on the bonds was reduced proportionately and Delta’s guaranty of the bonds was terminated. In the “Amended and Restated Lease” the term of the lease was also reduced from 25 to 10 years. The bonds are now secured by a pledge of the “Pledged Receipts” received by Massport from the rental of airline premises in the terminal (as well as amounts in various project funds and accounts) and Delta’s “settlement consideration” to satisfy its unsecured pre-petition claim, which was satisfied under Delta’s plan of reorganization.

In January 2007, the parties submitted various documents to the bankruptcy court reflecting a complex restructuring of Delta’s terminal lease and financing arrangements. The documents included a Settlement Agreement (between Delta Air Lines, Massachusetts Port Authority, Ambac Assurance Corporation, and The Bank of New York), the Amended and Restated Terminal A Lease, the Trust Agreement Amendment, the Escrow Agreement, and other related agreements. The

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<sup>24</sup> Standard & Poor's Ratings Services, *Massport's Special Facility Rev Bond Rating Cut Three Notches To 'D' Following Missed Payment*, January 4, 2006.

bankruptcy court subsequently approved the agreements in March 2007 and in its order granting the motion in February 2007 said:

*“The settlement and compromise reflected in the Settlement Agreement, is both fair and reasonable to, and is in the best interest of, the Debtors and their creditors, Massport, Ambac, the Trustee and the Bondholders and, in entering the Settlement Agreement, Delta, Massport, Ambac, and the Trustee have exercised their rights and powers and used the same degree of care and skill in their exercise as a prudent person would exercise or use under the circumstances.”*

In these agreements the parties acknowledged that the lease was a “true lease.” Delta was required to reimburse Ambac for the \$3.6 million debt service payment it had to make on January 1, 2006 and for Ambac’s legal, consulting, and other out-of-pocket expenses associated with the bankruptcy. Also, Delta agreed to fund a \$15,000,000 escrow account to be available in the event that Ambac is required to make payments to the bondholders under its insurance policy if there is a shortfall in “Pledged Receipts” available to pay debt service due on the bonds.

Under the revised agreements, Massport is required to use reasonable efforts to (1) re-let the Terminal A premises not occupied by Delta, (2) re-let any Terminal A premises subsequently surrendered by Delta, and (3) collect monthly payments of rent from replacement tenants. Massport pays to the trustee a portion of the re-letting proceeds from Delta and all other replacement tenants in accordance with a formula that was set forth in the original Terminal A lease. As before, there is no assurance that the amount of re-letting proceeds remitted by Massport to the trustee will be sufficient to pay the principal of and interest on the due on the bonds. The bonds remain special, limited obligations of Massport, payable only from Pledged Receipts. (It should be noted that the bondholders remain protected due to the guaranty provided by Ambac in August 2001 when the bonds were sold.)

The various layers of revenue and security established to pay bondholders under the settlement agreements includes:

- The allocable share of payments of rent by Delta under the amended lease
- The allocable share of re-letting proceeds paid by replacement tenants
- The approximately \$39 million debt service reserve fund
- The \$15 million escrow funded by Delta for Ambac’s benefit in the event it is needed to pay debt service
- The \$29 million unsecured claim that bondholders would receive in the form of a rental credit

Delta emerged from bankruptcy on April 30, 2007.

***Subsequent Events.*** After Delta and Northwest merged, Delta leased the remaining gates in Terminal A and Northwest moved its operations into Terminal A.

More recently, Massport applied to use PFCs for a portion of the Terminal A debt service because the annual debt service is scheduled to increase substantially and because Massport wanted to mitigate this impact on Terminal A rentals.<sup>25</sup>

#### **H.4.10 Lessons Learned**

This hybrid single airline special facility financing had a number of unique characteristics and as a result has provided some interesting and instructive lessons learned, including:

- Despite the representations that developers and infrastructure funds are looking for opportunities to invest private capital in airport assets, as was the case for the JFK IAT project, the prospective developers contended that the Terminal A project could not be economically financed without significant access to tax-exempt debt or other airport revenues.
- The experience of Terminal A at Logan and Terminal 4 at JFK highlight the difficulties of financing terminal buildings, with their high capital and operating costs, without the higher-margin parking and rental car revenues. A terminal developed by an airline, such as Terminal A at Logan, may be more feasible as the airline may be solving to minimize its overall operating costs rather than seeking satisfactory commercial returns on its investment. In the case of Delta, it was able to consolidate its operations that had been spread over two terminals into one building thereby saving on labor and equipment costs.
- Each state has its own unique set of laws and regulations. When contemplating privatization options, it is important to undertake a comprehensive review of these laws. Given the unique public bidding requirements in Massachusetts, accessing tax-exempt conduit financing for private development was deemed infeasible. Once Massport determined that private developers needed the conduit debt, it had to seek other avenues for private participation in the project.
- When contemplating a special facility financing on behalf of an airline or other party, an airport owner should be careful to ensure that the lease is a single lease that fits the parameters of a true lease (as opposed to a financing lease).
- Logan is primarily an origin-destination (O&D) airport and has a diverse mix of carriers, with no airline accounting for more than 20% of the passenger share in 2010. Under this type of situation, an airport owner should consider the desirability of including gate and space take-back provisions, as used in the Terminal A lease, if using special facility debt. Also, an airport should evaluate the merits of maintaining the facility on behalf of the airline (and charging associated rent) and retaining control over the concessions (and associated revenues).
- With respect to the construction side of the project, the lessons learned are best summarized by Massport's deputy chief legal counsel assigned to the Terminal A transaction:

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<sup>25</sup> Debt service on the bonds was structured so interest only was paid for the first 10 years and principal amortization started in (2011). The PFCs would be used to pay for debt service on the common areas of the building only.



*Take the time to carefully and clearly document the parties' understanding before commencing the work, but provide for flexibility within that framework; ensure that everyone involved in the project understands what has been agreed upon; maintain continuous communication throughout the project; and craft a structure that aligns all parties' goals. By taking time upfront, significant time and money can be saved in the long run.<sup>26</sup>*

- The lease required that Delta make annual maintenance reserve payments so that funds would be set aside for facility renovation, renewal, replacement, or reconstruction, and for unusual or extraordinary maintenance or repairs. This feature addresses concerns about a private tenant turning back a facility at the end of a long-term lease in poor condition. Funds in the Terminal A maintenance reserve account can be dispensed at Massport's discretion.

#### **H.4.11 References**

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Official Statement, Massachusetts Port Authority Revenue Bonds, Series 2005, May 5, 2005.

Official Statement, Massachusetts Port Authority Multi-Modal Revenue Bonds, Series 2008A&B, June 19, 2008.

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*Boston-Logan International Airport Terminal A Lease between The Massachusetts Port Authority and Delta Air Lines, Inc.*, August 15, 2001.

*Boston-Logan International Airport Terminal A Amended and Restated Lease between The Massachusetts Port Authority and Delta Air Lines, Inc.*, July 1, 2006.

*Settlement Agreement* (between Delta Air Lines, Massachusetts Port Authority, Ambac Assurance Corporation, and The Bank of New York), December 15, 2006.

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<sup>26</sup> Dave Bannard, *Large Capital Projects*, AAAE Airport Magazine, June/July 2010.

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Standard & Poor's Ratings Services, *Massport's Delta Terminal Facility Bonds Rating Lowered Five Notches To 'B'; Remains On Watch*, August 18, 2005.

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Yvette Shields, *Delta Escapes Its Boston Debt*, The Bond Buyer, December 19, 2006.

Dave Bannard, *Large Capital Projects*, AAAE Airport Magazine, June/July 2010.

## H.5 Stewart International Airport

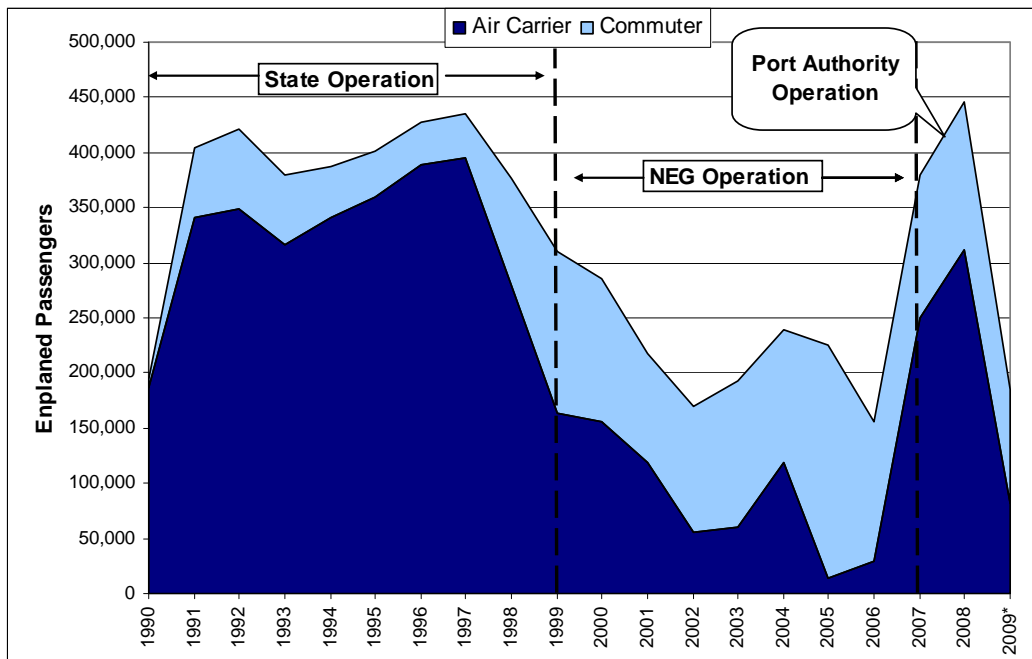
### H.5.1 Background

Stewart International Airport (“SWF” or “Stewart”) is a regional airport located in the central Hudson Valley area in the Orange County towns of New Windsor and Newburgh, approximately 60 miles north of New York City and 90 miles south of Albany. Its location adjacent to New York State Thruway I-87 and I-84, as well as its proximity to commuter and rail freight lines, make it a significant transportation asset to the region. The facility served as an Air Force Base until being deactivated in 1970 and turned over to the state of New York.

The airport occupies 2,452 acres and has two runways -- main east-west Runway 09/27 (11,817 x 150 feet)<sup>27</sup> and crosswind Runway 16/34 (6,006 feet x 150 feet) – and is capable of handling the world’s largest commercial and military aircraft, including the A-340, B-747, and C-5A. SWF operates as a joint civil-military airport housing the 105th Airlift Wing of the New York Air National Guard on the Stewart Air National Guard Base, which occupies 267 acres, and the Marine Aerial Refueler Transport Squadron 452 of the United States Marine Corps Reserve. In 1997, a new two-level passenger terminal concourse with 7 jet boarding bridges and 38 ticketing check-in stations opened. In 1998, the terminal was redesigned to add concession space, car rental agencies, and other enhancements. In late 2010, a new Federal Inspection Services facility opened in anticipation of Mexican service starting in 2011.

In 1990, SWF began operation as a commercial passenger airport. SWF has had a volatile history in terms of passenger traffic as shown in Figure 10.4, reflecting the entry and exit of numerous airlines.

**Figure H.4. Enplaned Passengers at Stewart International Airport**



Source: Federal Aviation Administration Terminal Area Forecast, December 2009. 2009 traffic is an estimate.

<sup>27</sup> Due to displaced thresholds and other operational issues, the effective lengths of the runways are 9,817 feet for Runway 29 and 8,817 feet for Runway 27.

Airline entries into and exists from the SWF market include:<sup>28</sup>

- American/American Eagle: April 1990-July 2007 Chicago and Raleigh/Durham.
- United Express: August 1990-January 2003. Washington D.C., Toronto, Boston.
- U.S. Airways (including U.S. Air, U.S. Air Express and Allegheny Airlines): January 1991-Present.
- Delta Air Lines: 1991-2005 (served by Delta's affiliate Comair 1998 on) Atlanta, Bangor, Cincinnati. 2007-Present: Atlanta
- TW Express: April 1992-1994 Commuter service to JFK.
- Jet Express: July 1993-January 1994.
- AirTran: Oct. 1994-July 1998 Orlando; January 2007-Sept. 2008 Atlanta, Florida
- Carnival: Nov. 1994-1997 Fort Lauderdale.
- Midway: June 1995-September 2001 Raleigh-Durham.
- Business Express (Delta affiliate): May 1995-May 1996 Boston.
- Southeast Airlines: September 2002-Nov. 2004 Florida.
- TransMeridian Airlines: May-July 2003, Feb.-July 2004 Las Vegas; (also Los Angeles May-June 2003).
- Northwest: June 2004-2009, which then merged into Delta, and continued service to Detroit.
- Independence Air: September 2004-Oct. 2005 Washington D.C. and Florida.
- Pan Am Clipper Connection: June 30-September 6, 2005 Florida.
- Allegiant Air: October 2005-January 2007 Florida.
- JetBlue: December 2006-Present Florida.
- Skybus: January-April 2008 Columbus, Greensboro.

As of November 2010, only three airlines served SWF:

- JetBlue Airways to Orlando and Ft. Lauderdale
- Delta Connection to Delta's Atlanta and Detroit hubs
- US Airways Express to US Airways' Philadelphia hub

DHL, FedEx, and USPS also operated daily at the airport.

There are two discrete parts to this case study – the transition from state to private control in early 2000 and the subsequent conversion back to public control in late 2007.

In 1999, the airport became the first and only<sup>29</sup> airport to complete the Airport Privatization Pilot Program (“APPP”) process. It was operated by SWF Airport Acquisition, Inc. (“SWFAA”), a subsidiary of UK-based National Express Group (“NEG”), under a 99 year lease with the state. NEG operated the airport from November 1, 1999 through October 31, 2007, when it sold the remaining 91 years of the lease to the Port Authority of New York and New Jersey (“Port Authority”). Because the Port Authority is a public agency and not a commercial entity, the airport was no longer eligible to continue in the APPP under Port Authority control and its participation in the program was terminated.

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<sup>28</sup> Michael Randall, *Stewart Airport's seen plenty of ups and downs*, Times Herald-Record, November 21, 2010.

<sup>29</sup> As of November 2011.

## H.5.2 Timeline for Stewart’s Ownership and Control

The airport has had a long and unsettled history. Stewart was originally developed in the 1930s as a military base and remained under military control until it was deactivated as an Air Force base in 1970 and was deeded to the state. The state ceded ownership of the airport first to the New York State Metropolitan Transportation Authority (“MTA”), then to the New York State Department of Transportation (“NYSDOT”) before deciding to privatize it in 1995 under a 99-year lease.

A summary of the key events during the airport’s various ownership and management phases is shown in Table H.9.

**Table H.9. Stewart Privatization Timeline**

<b>Early Development</b>	
1930	<ul style="list-style-type: none"> <li>Samuel Stewart donated 220 acres of pasture land to the City of Newburgh for an airport</li> </ul>
1934	<ul style="list-style-type: none"> <li>US Military Academy selected the site for a West Point airfield for cadet flight training</li> </ul>
1942-1945 (WWII)	<ul style="list-style-type: none"> <li>Army used Stewart used as a flight training base and constructed numerous barracks and other buildings</li> </ul>
1948	<ul style="list-style-type: none"> <li>Airport converted to an Air Force base</li> </ul>
1970	<ul style="list-style-type: none"> <li>Stewart was deactivated as an Air Force base</li> <li>Orange County formed a task force to consider taking over Stewart and operating it as a commercial airport. County concluded conversion would be too expensive and decided not to participate in taking over the base</li> <li>U.S. government transferred 1,598 acres of land and improvements to the MTA under a Quitclaim Deed that required that the property be used for public airport purposes</li> </ul>
<b>State Operation</b>	
1971	<ul style="list-style-type: none"> <li>The state 854 additional acres of property by condemnation under the New York State Highway Law</li> <li>Governor Rockefeller, seeing the potential for SWF’s long runways to serve the supersonic transports under development at that time, had a vision and plan to convert SWF into the New York metropolitan area’s fourth major airport, and tripled the airport’s property using eminent domain powers</li> <li>Area residents fought the airport expansion causing the state to promise it would only develop the site for airport facilities</li> <li>SST supersonic transports development in the U.S. cancelled</li> </ul>
1973	<ul style="list-style-type: none"> <li>Oil crisis and associated jet fuel increases and airline service reductions, caused some of the airport’s original backers to question the economically viable of the airport</li> <li>State plans for airport development put on hold</li> </ul>
1976	<ul style="list-style-type: none"> <li>State abandoned plans for airport development</li> </ul>
1976 – 1982	<ul style="list-style-type: none"> <li>Site remained unoccupied</li> </ul>
1982	<ul style="list-style-type: none"> <li>State transferred ownership of SFW from the MTA to the NYSDOT</li> </ul>
1983	<ul style="list-style-type: none"> <li>In response to local concerns about SWF governance, the New York legislature created the SWF Airport Commission</li> <li>105th Airlift Wing and 213th Engineer Installation Squadron of the NY Air National Guard moved into the airport (called the Stewart Air National Guard Base)</li> </ul>
Mid – late 1980s	<ul style="list-style-type: none"> <li>Corporate jet hanger built by W.R. Grace became the first private tenant at SWF</li> <li>Industrial park was started</li> <li>Portions of undeveloped land (Stewart Properties or “the buffer”) turned over to the New York State Department of Environmental Conservation (“NYSDEC”) by the NYSDOT</li> </ul>

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1989	<ul style="list-style-type: none"> <li>▪ SWF began operation as a commercial passenger airport</li> </ul>
1990	<ul style="list-style-type: none"> <li>▪ 50,000 square foot air cargo building and 300,000 square foot US Postal Service federal mail distribution facility opened</li> </ul>
1991	<ul style="list-style-type: none"> <li>▪ SWF becomes the first facility to receive funding under the FAA Military Airport Program (\$5 million)</li> <li>▪ SWF also received a \$900,000 FAA grant to update the master plan, conduct an environmental review, and prepare a noise capability study.</li> <li>▪ SWF received \$13 million in federal funding for rehabilitation of the fuel farm, terminal parking ramp, part of its taxiway system and upgrades to the airside signage. And in 1992,</li> </ul>
1992	<ul style="list-style-type: none"> <li>▪ SWF received \$3 million from the FAA Military Airport Program for terminal expansion</li> </ul>
<b>State Privatization Process</b>	
1994	<ul style="list-style-type: none"> <li>▪ Governor Pataki's New York State Council on Privatization began consideration of privatization; however, the APPP was not yet available</li> </ul>
1995	<ul style="list-style-type: none"> <li>▪ SWF levied a passenger facility charge</li> </ul>
October 1996	<ul style="list-style-type: none"> <li>▪ Federal Aviation Authorization Act of 1996 enacted, which established the Airport Privatization Pilot Program</li> </ul>
June 1997	<ul style="list-style-type: none"> <li>▪ State issued Stewart Airport Privatization RFP, which included options for adjacent undeveloped lands</li> </ul>
September 1997	<ul style="list-style-type: none"> <li>▪ FAA promulgated airport privatization regulations</li> </ul>
October 1997	<ul style="list-style-type: none"> <li>▪ Five groups respond to Stewart RFP</li> <li>▪ NYSDOT filed a preliminary application for participation in APPP</li> </ul>
December 1997	<ul style="list-style-type: none"> <li>▪ FAA approved SWF preliminary privatization application</li> </ul>
April 1998	<ul style="list-style-type: none"> <li>▪ National Express Group named as preferred bidder with a bid of \$35 million, but did not choose to lease the additional lands</li> </ul>
January 1999	<ul style="list-style-type: none"> <li>▪ Final privatization application filed with FAA</li> </ul>
March 1999	<ul style="list-style-type: none"> <li>▪ International Union of Operating Engineers representing the airport employees notified the FAA that Local 825 and NEG had reached an agreement covering both airport operations and maintenance employees</li> </ul>
April 1999	<ul style="list-style-type: none"> <li>▪ FAA published notice for 60-day public comment period</li> </ul>
June 1999	<ul style="list-style-type: none"> <li>▪ FAA conducted public hearing on SWF privatization</li> </ul>
August 1999	<ul style="list-style-type: none"> <li>▪ Orange County Building and Construction Trades Council and SWFA concluded a PLA for a 5-year term</li> <li>▪ Stewart Airport Commission endorsed privatization lease</li> </ul>
September 1999	<ul style="list-style-type: none"> <li>▪ Lease is signed and copies were forwarded to the FAA, state comptroller, and state attorney general for approval</li> </ul>
February 2000	<ul style="list-style-type: none"> <li>▪ State attorney general completed lease review</li> </ul>
March 2000	<ul style="list-style-type: none"> <li>▪ State comptroller completed lease review</li> <li>▪ FAA approved privatization application (March 30)</li> </ul>
April 1, 2000	<ul style="list-style-type: none"> <li>▪ Lease became effective and SWF became the nation's first commercial airport to be privatized under the APPP</li> </ul>
<b>NEG Operation</b>	
Late 2000	<ul style="list-style-type: none"> <li>▪ Management of 5,600 acres west of Drury transferred to NY Department of Environmental Conservation (DEC), which later created Stewart State Forest from the un-leased lands</li> <li>▪ State commenced work on a new interchange on Interstate 84 at Drury Lane, the widening of Drury Lane, and a 4-lane east-west access road (International Boulevard) to address the airport's longstanding access problems</li> </ul>
March 2007	<ul style="list-style-type: none"> <li>▪ NEG sold East Midlands, Bournemouth, and Humberside airports to the Manchester Airport Group</li> </ul>
November 2005	<ul style="list-style-type: none"> <li>▪ To settle a lawsuit to allow development of the new SWF exit, 1,700 acres of the remaining buffer was added to the proposed Stewart State Forest and development restrictions were placed on the remaining 400 acres near the exit</li> </ul>

Summer 2006	<ul style="list-style-type: none"> <li>▪ NY State formally transferred ownership of the State Forest from DOT to DEC, and officially creates the Stewart State Forest</li> <li>▪ New state-of-the-art control tower was commissioned by the FAA</li> </ul>
<b>NEG Sells Lease</b>	
September 2006	<ul style="list-style-type: none"> <li>▪ NEG announced plans to sell its SWF lease</li> </ul>
October 2006	<ul style="list-style-type: none"> <li>▪ NEG sent letter to the FAA informing it of its intention to solicit investors to purchase its leasehold interest at SWF</li> </ul>
January 2007	<ul style="list-style-type: none"> <li>▪ Port Authority voted to buy the SWF operating lease from NEG for \$78.5 million for the 93 remaining years</li> </ul>
May 2007	<ul style="list-style-type: none"> <li>▪ New Jersey acting governor signed a bill to allow the Port Authority to take over SWF operations, matching the NY equivalent law</li> </ul>
<b>SWF Transferred to Port Authority</b>	
July 2007	<ul style="list-style-type: none"> <li>▪ Port Authority and NEG executed an Asset Purchase Agreement for the SWF lease</li> <li>▪ NYSDOT announced a feasibility study of connecting SWF to the Port Jervis Rail Line at Salisbury Mills (three miles) to connect with Metro-North service.</li> <li>▪ Port Authority and NJ Transit sponsored a \$5.4 million West of Hudson Regional Transit Access Alternatives Analysis Study that will include mass-transit options for Stewart International Airport</li> </ul>
October 2007	<ul style="list-style-type: none"> <li>▪ FAA approved and consented to the Lease Assignment and consented to the Port Authority's assumption of NEG's federal obligations, including AIP grants, PFC records of decision, and surplus property; closing occurred on October 31, 2007</li> <li>▪ FAA determined that the Port Authority is a public agency and not eligible for the airport privatization program and terminates SWF's participation in the program</li> </ul>
November 2007	<ul style="list-style-type: none"> <li>▪ Port Authority takes over lease from NEG</li> <li>▪ Port Authority announced \$500 million in capital improvements at SWF over the next 10 years</li> <li>▪ New airport Drury Lane interstate exit off I-84 and access road opened</li> </ul>
July 2010	<ul style="list-style-type: none"> <li>▪ Port Authority announced intention to spend \$50 million at SWF by the end of the year for upgrades to attract new airlines and improve service, including runways, taxiways, deicing procedures, new parking facilities that recycle runoff water, energy efficiency lights, electrical infrastructure upgrades, and electrified jetways</li> </ul>

### H.5.3 Privatization Objectives and Motivations

A privatization initiative in New York State coincided with the development of the APPP.<sup>30</sup> In 1994, Governor George Pataki formed the New York State Council on Privatization, which considered a broad range of New York State asset and operation privatization alternatives. SWF was determined to be a good candidate for privatization. However, federal law at the time significantly restricted the state's ability to privatize SWF. Two other New York airport privatization initiatives were also identified at that time -- the private construction of JFK Terminal Four and the privatization of the Niagara Falls International Airport.

The primary motivations for the SWF privatization were to (1) leverage the expertise of the private sector to develop the underutilized airport to its fullest potential and (2) develop the real estate on the vast site to create jobs and economic development, which was a priority for the Hudson River Valley due to IBM and other large industrial concerns laying off workers and closing plants. The state thought that the adjoining undeveloped real estate (west of Drury Lane) had significant value; however, the economic climate and environmental concerns at that time did not align with the state's expectations.

<sup>30</sup> New York State commented in support of the development of the APPP.

Managing airports is not a “core business” for the state. The state only owned SWF and Republic Airport, a commuter airport on Long Island, and it assumed SWF ownership only after Orange County declined to pursue acquisition from the federal government when the Air Force Base was deactivated. Also, NYSDOT was continually funding SWF with no hope of financial return.

Upon the transfer of SWP to NEG in March 2000, there was resounding support for the transaction as evidenced by various key stakeholder comments, including:<sup>31</sup>

**Governor George Pataki:**

*“Today is an historic day for New Yorkers because once again the Empire State is the national leader in new and innovative policies. With the eyes of the world on us, we have again returned government to its proper role of helping the private sector unleash its potential to create jobs and opportunities for the people. As we transfer Stewart to National Express Group, we are doing more than just turning over the keys. We are unlocking the door for the private sector to come in and provide the Hudson Valley region with better air travel services, greater economic development, and a strengthened tax base.”*

**Ronald S. Lauder, Chairman of the New York State Research Council on Privatization:**

*“Today New York became the first state in the nation to privatize a commercial airport. With privatization cleared for take off, New York is again using the power of private enterprise to benefit air travelers and taxpayers. Governor Pataki is showing the nation there is a better way to improve airports. It's privatization. It works in New York and it can work across the country.”*

**William Rollason, NEG chief financial officer:**

*“...Our goal is to make Stewart Airport the premier, state-of-the-art model of airport privatization that the rest of the country will want to emulate. We are committed to making this partnership between the public and private sectors work. Our number one priority is to bring the same level of high-quality service to the people of New York as we have already done with our transportation activities throughout the United Kingdom, Australia, and the rest of the United States”*

**Jim Wright, Chairman of the Stewart Airport Commission:**

*“Stewart will finally reach its potential as an economic generator for the mid-Hudson Valley region under private ownership. Governor George Pataki is to be commended for his initiative and courage in pioneering the privatization concept for Stewart Airport.”*

**Mary Crabb, Newburgh Mayor:**

*“Once again Governor Pataki delivers for our region. The privatization of Stewart Airport is a long awaited opportunity to promote the region's economy. We are busy working to improve the conditions of our people and our city. This initiative of the Governor will provide momentum needed to achieve our goals. The future of the City of Newburgh is directly tied to the future and success of Stewart Airport.”*

Clearly, the parties felt that NEG would not only turn the airport around, but would also develop Stewart to its fullest potential under private management for the full 99-year lease, and that this would be a landmark transaction that would become a model for airport privatization throughout the country.

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<sup>31</sup> New York State Department of Transportation Press Releases, *Governor Pataki Hands Stewart Airport Keys to National Express*, March 31, 2000.



#### H.5.4 Privatization Transaction Process

Prior to privatization and throughout the privatization process, NYSDOT contracted with Air Group International (“AGI”) to operate the airport under a management contract. In addition, the parking operations were contracted to another private entity and NYSDOT leased the airport’s cargo facilities. While the ownership of SWF resided with NYSDOT, a significant amount of SWF operations were outsourced to contractors.

The mechanics of the privatization process were handled by the Empire State Development Corporation (“ESDC”), an economic development agency of the state, and NYSDOT. ESDC and NYSDOT assembled a team of consultants that managed the privatization process under ESDC and NYSDOT project managers. The consulting team assisted with the development of the RFP, proposal evaluations, preliminary and final FAA applications, and lease negotiation.

The RFP called for a 99-year lease and gave the bidders the option of proposing on (1) the airport, (2) just the undeveloped land west of Drury Lane (approximately 5,600 acres), or (3) both. Some teams included proposals for the undeveloped lands and some did not. There was a significant amount of public opposition to the development of the undeveloped properties by local residents and environmental groups.

One of the conditions of the lease was to retain the State Troopers as the airport security to avoid labor issues. The bidders accepted this arrangement as the airport has territory in three jurisdictions, making the State Troopers a logical choice.

Five teams submitted proposals, which were reviewed and evaluated by ESDC, NYSDOT, and their consultants. There were four qualified bidders: NEG, AGI, LCOR/Rockefeller Group, and Johnson Controls. The bidders who proposed land development components offered only contingency deals. The state preferred firm commitments with guaranteed cash payments.

NEG was considered the clear choice on all evaluation criteria, and proposed to lease the airport through a subsidiary, SWF Airport Acquisition, Inc. NEG elected not to bid on the undeveloped land, and at the encouragement of environmental groups, most of the undeveloped land was set aside by the state under a “forever green” statute. As the Pataki administration was pro-environment, the lack of meaningful bids helped justify the political decision to set the land aside, which was subsequently converted to the Stewart State Forest.

There was a “best and final” offer process for the bidders, after which the gap between NEG and the other bidders widened. The evaluators found NEG’s experience in previously privatizing the UK national bus service and three English regional airports highly relevant and transferable.<sup>32</sup>

In terms of the APPP process, the timeline was as follows:

- On October 23, 1997, NYSDOT filed a preliminary application for participation

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<sup>32</sup> In June 1993, NEG acquired East Midland International Airport for £45 million (\$US 68 million). It later acquired Bournemouth International Airport and Humberside Airport. However, NEG sold all three airports to the Manchester Airport Group for £241 million in February 2001 (\$US 354 million). The Manchester Airport Group is a public authority so the transaction paralleled the later sale of the SWF lease to the Port Authority.

- On January 10, 1999, NYSDOT filed its final application for the privatization of SWF
- On February 16, 1999, in an effort to clarify certain parts of the application, FAA staff requested responses questions from NYSDOT and NEG
- On April 8, 1999, the FAA published a Notice of Receipt of Final Application in the Federal Register
- On June 12, 1999, a public meeting was held
- On March 30, 2000, the FAA issued its Record of Decision approving the privatization application and approved the requested federal exemptions

As noted above, the FAA published a notice in the Federal Register and held a public meeting on the SWF privatization. The FAA received 96 comments in response to the notice from elected officials, civic organizations and citizen groups, businesses, labor unions and contractors, economic development organizations, environmental and noise groups, and private citizens. The table below summarizes the major comments received.

**Summary of Written Comments on Privatization Summarized from  
FAA-03-14961-6 (24)<sup>33</sup>**

Pro	Con
Beneficial economic impact on the surrounding region	Possible adverse impact on the environment
Enhance capital investment, improve air service and customer amenities, and attract jobs and businesses	Increase in airport traffic
Increase the tax base and provide a financial return on long-term government investment	A 25-30 year lease term would be more appropriate
Help solve the capacity problems at the other three NY airports	

NEG took over operation on April 1, 2000.

The privatization process, which began in 1994, took almost 4 years from its announcement in January 1996 until NEG took over the airport in November 1999. However, because SWF was the first airport to go through the APPP process, the framework for the APPP was developed through the advancement of the SWF process, which was later followed by the city of Chicago in the Midway transaction. According to a participant in the privatization process, the FAA was supportive, responsive, and proactive in finding solutions throughout the process.

### **H.5.5 Privatization Transaction Summary**

**Payments.** NEG proposed an “Initial Lease Payment” of \$35 million and annual payments equal to 5% of gross income that were projected to be begin on or about the 10<sup>th</sup> anniversary of the lease. The amount and timing of payments to NYSDOT was as follows:<sup>34</sup>

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<sup>33</sup> U.S. Department of Transportation Federal Aviation Administration, *Record of Decision for the Participation of Stewart International Airport in the Airport Privatization Pilot Program*, March 31, 2000. See in particular, Attachment Six FAA Response to Comments Regarding the Participation of Stewart International Airport in the Airport Privatization Pilot Program.

**Table H.10. Summary of NEG Financial Terms**

<b>Payment</b>	<b>Timing of Payment</b>	<b>Amount of Payment</b>
First lease payment	Commencement of lease	\$24 million
Second lease payment	Secured by a letter of credit at lease commencement and to be paid the earlier of completion of the airport access road or 10th anniversary of the lease commencement	\$5 million plus interest
Third lease payment	Secured by a letter of credit at lease commencement and to be paid upon NYSDOT's completion of environmental remedial action as outlined in the lease	\$6 million plus interest
Annual payments	Commencing on the earlier of the 10 <sup>th</sup> anniversary of the lease commencement date or when total passenger traffic reaches 1,380,000	5% of gross airport income

**No Revenue Diversion.** After being accepted under the APPP by the FAA in December 1997, NYSDOT began negotiations with the airlines. Under the APPP, in order for the state to apply lease revenues from the transaction for general state purposes, the lease must receive the approval of both 65% of the airlines operating at SWF and airlines representing 65% of the annual landed weight. This provision gave the SWF carriers at that time (American, Comair, Midway, United Express, and US Airways Express) considerable bargaining power. The airlines declined to approve NYSDOT's request for an exemption to use airport revenue for general purposes because they were concerned that granting the exemption for SWF would establish a precedent that could be used in the privatization of larger airports.

Therefore, when filing its final APPP application for SWF, NYSDOT did not request an exemption under 49 USC 47134 (b)(1) of the APPP for use of airport revenue for general purposes. NYSDOT stated its intent to use both the \$35 million initial payment and the 5% of gross annual payments starting on the 10th anniversary of the lease for airport purposes, including:<sup>35</sup>

- \$2.5 million (\$500,000 per year for 5 years) for capital and operating costs at its other airport, Republic Airport in Farmingdale, NY, which is owned and operated by NYSDOT and is part of the local airport system.
- \$24.7 million for reimbursement for capital contributions and operating expenses incurred in the preceding 6 years that do not constitute prohibited revenue diversion. These funds were spent to construct projects including the water and sewage distribution systems for SWF and Republic Airport.<sup>36</sup>
- \$2.5 million for the costs (1) incurred as a result of the privatization initiative, (2) ensure continued operation of the airport in the event of default by the lessee, (3) general lease oversight costs, and (4) completion of capital projects.
- \$2,150,000 for future capital projects at SWF.

<sup>34</sup> *Agreement of Lease Between NYSDOT and SWF Airport Acquisition, Inc.*, September 24, 1999.

<sup>35</sup> U.S. Department of Transportation Federal Aviation Administration, *Record of Decision for the Participation of Stewart International Airport in the Airport Privatization Pilot Program*, March 31, 2000; and New York State Department of Transportation, *Final Application Under the Airport Privatization Pilot Program*, January 8, 1999.

<sup>36</sup> At the request of the FAA, an audit was performed by Watson Rice LLP, Certified Public Accountants, dated December 1, 1999, contracted by the state, which verified that \$24,777,793 was spent for airport purposes.

- \$8.5 million towards the new on-airport roadway in connection with the planned new freeway exit.

**Airline Rates and Charges.** NYSDOT said in its final application that NEG intended to freeze the current signatory rates and charges at the 1998 levels (other than for capital expenditures) until a 5% equivalent reduction in these fees is achieved relative to changes in the consumer price index. Once this reduction is achieved, the fees imposed on the air carriers just prior to the transfer (i.e., in 1998) would not increase faster than the rate of inflation (unless agreed to by 65% of carriers pursuant to APPP regulations), other than for the funding of new capital development after the transfer. In addition, in connection with the proposed 5-year Capital Improvement Plan prepared by NEG, NEG expected to include a reasonable rate of return (including the cost of capital and risk premium) on capital expenditures for the airside and adjust the landing fee rate accordingly.

However, with respect to the airline rates and charges, in its Record of Decision approving the privatization, the FAA said:<sup>37</sup>

*“The FAA interprets 49 U.S.C. § 47134(c)(4) to require approval of 65 per cent of the carriers serving SWF (calculated based both on absolute number and on landed weight) for airport rate increases greater than the rate of inflation and not as a result of capital improvements. SWFAA proposes to maintain existing air carrier rates at 1998 price levels until increases in the consumer price index reflect a 5% reduction for fees not attributable to increases due to capital investment.”*

*“We would expect SWFAA to establish aeronautical fees in consultation with SWF’s aeronautical users, in accordance with FAA’s Policy Regarding Airport Rates and Charges. (See 61 FR 31994, par. 1. I, et seq.)”*

In sum, while the state and NEG thought it was reasonable to include the cost of capital in the airline rates over and above allowances for inflation without having to seek airline approval, the FAA said that rates could not increase faster than the rate of inflation without airline approval.

**NEG Rate of Return.** The Quitclaim Deed was also modified to allow NEG to earn a reasonable rate of return on its investment and risk in operating the airport over the lease term. NEG planned to increase airport revenue from non-aeronautical sources through new concession and property rental income to (1) fund ongoing airport operations and the airport’s capital improvement program and (2) provide NEG with a return on its investment (estimated to be between 3% and 35%). Although the FAA granted this exemption, it said the exemption was not unlimited and could only be available after NEG met its obligation for investment in airport operations and capital development under the grant assurances and the lease. FAA also said:

*“Compensation in excess of this range would be subject to review for compliance with requirements for use of airport revenue under § 471 07(b) and the obligation under the grant assurances that aeronautical rates and charges be fair and reasonable.”*<sup>38</sup>

**Capital Improvement Program.** The final application included a 5-year indicative capital improvement plan (“CIP”) of \$48.6 million with NEG’s share as \$10.2 million. The remainder was

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<sup>37</sup> U.S. Department of Transportation Federal Aviation Administration, *Record of Decision for the Participation of Stewart International Airport in the Airport Privatization Pilot Program*, 2003.

<sup>38</sup> U.S. Department of Transportation Federal Aviation Administration, *Record of Decision for the Participation of Stewart International Airport in the Airport Privatization Pilot Program*, March 31, 2000.

to come from AIP grants, passenger facility charges, and charges to airport tenants.

**Assignment of Lease.** In the lease, NYSDOT reserved the right to approve any assignment of the lease and prohibited NEG from selling the lease for a period of 5 years. NYSDOT also retained the right to re-enter and operate the airport in the event NEG were to interrupt airport operations after filing for bankruptcy and other events of default.

**Labor.** Under the APPP statute, any collective bargaining agreements covering airport employees that are in effect on the date of the sale or lease of the airport cannot be abrogated by the sale or lease. Therefore, NYSDOT required NEG to develop a plan offering existing NYSDOT employees at the airport the option to remain in the employment of NYSDOT or to receive an offer of employment with NEG.

NEG reached an agreement with the International Union of Operating Engineers (representing the airport employees) covering airport operations and maintenance employees. In addition, NEG concluded Project Labor Agreement (PLA) with the Orange County Building and Construction Trades Council, which provided:<sup>39</sup>

- NEG enter into a PLA for an \$8 million runway re-surfacing project.
- For a 5-year period, all major construction projects over \$1 million undertaken by NEG will be performed under a PLA. For all projects under \$1 million, local contractors with labor agreements will be used.
- A labor advisory board will be established consisting of representatives from NEG and labor to consider projects for a PLA and eligible contractors with labor agreements.
- A Harmony Clause encourages all tenants, concessionaires and customer organizations undertaking construction on the airport to hire contractors employing union labor.

**Community.** Section 401 of the State Transportation Law established the Stewart Airport Commission (“SAC”) to advise the NYSDOT Commissioner on matters relating to the operation, management, and financing of the airport.<sup>40</sup> SAC remains the principal source of contact between the airport and the community on airport matters through its regular public meetings and its noise subcommittee. The SAC is advisory only and has no governance authority over the airport. Commission membership includes the NYSDOT Commissioner, the elected heads of the 3 surrounding counties and 10 appointed representatives of the local communities. The Commission initial goals were and continue to be to (1) improve passenger air service and (2) contribute to the region’s economic development. Under the lease, NEG was required to meet on a regular basis with SAC.

## H.5.6 Experience Under Private Control

Shortly before the beginning of the lease term in November 1999, NEG approached NYSDOT asking to be relieved of its lease obligations. Apparently, NEG had already started thinking about getting out of the airport business to focus on its core business in the bus and rail sectors, and in

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<sup>39</sup> U.S. Department of Transportation Federal Aviation Administration, *Record of Decision for the Participation of Stewart International Airport in the Airport Privatization Pilot Program*, March 31, 2000.

<sup>40</sup> The SAC was created by the New York legislature in 1983 in response to local concerns about SWF governance.

February 2001 sold its only other airport operations (3 airports in England). NYSDOT refused the request and NEG proceeded as contracted to take over SWF operations. However, the SWF transaction prohibited the sale of the lease to another party for 5 years, or until November 1, 2004.

NEG hired an experienced airport manager to run SWF who was not an employee of NEG but was a contractor. The airport manager continued in that position until the airport lease was taken over by the Port Authority and reported to NEG's U.S. subsidiary, which was a large bus operation. SWF had to perform as a competitive business enterprise within the NEG family of companies. Ongoing corporate investments and initiatives had to be justified by reasonable expectation of a satisfactory financial return over the life of the investment. Potential SWF investments also had to compete with potential rail and bus investments within NEG's capital portfolio. Beyond the lease commitments, investments at SWF had to be as good as or better than alternative NEG investments.

NEG took over operations roughly 10 months before the terrorist events of September 11, and managed SWF during a difficult period for regional airports. It competed successfully for AIP grants and worked to attract real estate development and airline service, including JetBlue and AirTran (which subsequently exited the market).

In its August 2004 report to Congress on the status of the APPP, the FAA compared the capital plans and net revenues of SWF under NYSDOT and NEG control. Regarding the 5-year CIP, the FAA concluded that NEG proposed (1) \$4.3 million more than most recent NYSDOT CIP, (2) reduced its reliance on federal and state grants, and (3) proposed a private capital contribution as summarized below.<sup>41</sup>

**Table H.11. Comparison of Capital Plans under NYSDOT and NEG**

(millions \$)			
Funding Source	NYSDOT	NEG	Variance
AIP grants	\$39.9	\$29.0	(\$10.0)
State grants	2.0	--	(2.0)
Passenger Facility Charges	2.3	9.2	6.9
Local funds	0.1	--	(0.1)
Private operator		0.1	0.1
Tenant		10.3	10.3
Total	\$44.3	\$48.6	\$4.3

In terms of the profits from airport operations, the FAA concluded that despite a steady decline in passengers after NEG took over operation -- between 1999 and 2003 passengers declined 38% from 309,948 to 193,436<sup>42</sup> -- NEG's profit was similar to that achieved by NYSDOT under its last full year of operation, which was likely a result of operating efficiencies achieved by NEG.<sup>43</sup>

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<sup>41</sup> U.S. Department of Transportation, Federal Aviation Administration, *Report to Congress on the Status of the Airport Privatization Pilot Program*, August 2004.

<sup>42</sup> Federal Aviation Administration, *Terminal Area Forecast*, December 2009.

<sup>43</sup> U.S. Department of Transportation, Federal Aviation Administration, *Report to Congress on the Status of the Airport Privatization Pilot Program*, August 2004.

**Table H.12. Comparison of Financial Performance under NYSDOT and NEG**

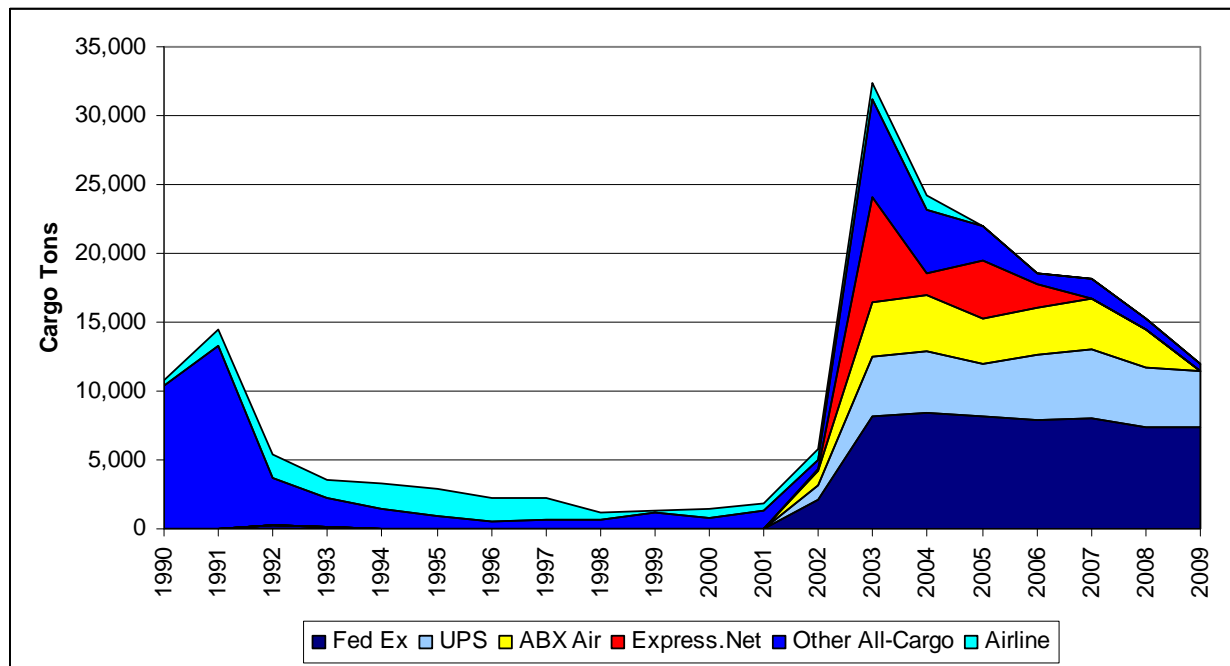
Year (Operator)	Operating Revenue	Operating Expenses	Operating Profit(Loss)
1999 (NYSDOT)	\$8,205,223	\$6,314,768	\$1,890,455
2000 (NYSDOT & NEG)	5,989,413	7,118,342	(1,128,929)
2001 (NEG)	7,568,238	5,715,135	1,853,103
2002 (NEG)	7,052,516	5,633,610	1,418,906
2003 (NEG)	7,775,485	6,243,846	1,531,639

Although the SWF privatization did not materially improve passenger air service, it did continue economic development activity related to the airport and was able to accelerate construction projects relative to public operation. For example, the FAA also noted in its report to Congress:<sup>44</sup>

- According to NYSDOT, NEG improved the airport’s relationship with the business community in its effort to support regional growth. For example, NEG partnered with a major real estate developer to promote the airport and a 260 acre, 2 million square foot office park on land adjacent to the airport. NEG also executed a lease with General Electric to build a \$24 million corporate aviation center at SWF that allowed GE to move its operation from Westchester County Airport to SWF.
- NYSDOT officials also reported that private funding of the airport’s environmental cleanup allowed the work to be performed faster than under state control.

NEG also competed successfully for AIP grants and was successful in attracting freight service back to the airport as shown in Figure H.5.

**Figure H.5. All-Cargo Tonnage at Stewart International Airport by Carrier**



Sources: U.S. DOT, Schedules T100 and 298C T1.  
Note: Includes enplaned and deplaned freight and mail.

<sup>44</sup> Id.

NEG signed deals to develop a hotel, private jet hangars, and a new cargo facility. It also renovated the terminal and brought in new vendors. However, when NEG announced it was planning on selling its leasehold interest in September 2006, Jim Wright, chairman the Stewart Airport Commission, best summed up the community's position:

*"Real estate development is fine, but what Stewart needs is flights. Many more flights. We need someone to jump-start the airport. We've got to get more passenger service in here."<sup>45</sup>*

### **H.5.7 Sale of the Lease to the Port Authority**

As noted earlier, shortly after signing the lease, NEG made a strategic decision to exit the airport business to focus on its core bus and train businesses. It sold its UK airport interests. However, the lease forbid NEG from selling the lease for 5 years, or until November 1, 2004.

As the lease sale prohibition period wound down, NEG commenced private talks with potential acquirers. The Port Authority was interested in acquiring the lease, but Governor Pataki preferred that it stay in the hands of a private operator. It was reported that NEG had negotiated a potential deal with a private entity when Governor Spitzer's administration took office and he reversed the private operator policy and allowed the Port Authority to enter the bidding process.

Realizing that the region needed additional capacity beyond what investments at its three New York area airports could provide (which had been projected to reach capacity by 2020), the Port Authority made a strategic decision to bid on the SWF lease to develop Stewart into a reliever airport for the region.

As noted by Governor Spitzer in January 2007:

*"We will continue to make major investments at J.F.K., Newark and La Guardia, but eventually we are simply going to run out of room. Stewart International Airport will provide much-needed relief for our three major airports, greatly reduce delays and help us prepare for inevitable population and passenger growth."<sup>46</sup>*

The decision by Governor Spitzer was important to the return of SWF to operation by a public authority and the end of the privatization period. Without a change in policy direction in the governor's office, the airport lease would likely have been sold to another commercial operator instead of the Port Authority.

Before the Port Authority settled on SWF, it studied several other alternatives to help alleviate congestion and ease delays at the New York-New Jersey metropolitan-area airports, including Long Island Islip MacArthur Airport and Westchester County Airport.

On September 29, 2006, NEG publicly announced plans to sell its SWF lease. NEG had signed deals to develop a hotel, private jet hangars, and a new cargo facility at SWF. On October 5, 2006, NEG sent a letter to the FAA informing it of its intention to solicit investors to purchase its leasehold interest at SWF.

On January 25, 2007, the Port Authority voted to buy the SWF operating lease for \$78.5 million for the 91 remaining years. The Port Authority reportedly offered more money than the other deal

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<sup>45</sup> Tim Logan, *Stewart loses operator, National Express opts to drop its lease*, Times Herald-Record, September 29, 2006.

<sup>46</sup> Patrick McGeehan, *4th Major Hub for Air Traffic Moves Ahead*, New York Times, January 25, 2007.



NEG was considering in return for the additional time required for the Port Authority to make the governance adjustments to allow them to acquire the SWF lease.<sup>47</sup>

On July 17, 2007, the Port Authority and NEG executed an Asset Purchase Agreement for the SWF lease. The price was \$78.5 million and included paying off a \$2.8 million dollar letter of credit from the original NEG lease for environmental remediation work that the state had not finished.

The state consented to the lease assignment and the TSA approved the amended Airport Security Plan<sup>48</sup>, which allowed the FAA to approve and consent to the lease assignment and the Port Authority's assumption of NEG's federal obligations, including AIP grants, PFC records of decision, and surplus property instruments of conveyance on October 31, 2007. At the same time, the FAA terminated the exemption granted to waive the requirement to repay federal grants and to earn compensation from the operation of SWF under private operation. In addition, the FAA determined that the Port Authority was a public agency and not eligible for the airport privatization program. The FAA therefore terminated SWF's participation in the pilot program.

The Port Authority took over SWF operations on November 1, 2007. It took just over a year from NEG's public announcement of its intent to sell the lease until it closed the purchase with the Port Authority. The Port Authority had put a shadow management team in place at SWF well in advance of the takeover. The Port Authority now has a Port Authority employee team managing the airport and a contractor for all operations -- AvPorts, which also operates Teterboro Airport for the Port Authority. In general, many of the airport operations employees have largely stayed intact throughout the several iterations of operators (state, NEG, Port Authority).

At the time of the closing and takeover, the Port Authority had approved more than \$17 million for parking and roadway improvements for Stewart.

Almost coincident with the Port Authority's takeover of SWF in late 2007, the new airport Drury Lane interstate exit off I-84 and access road opened, improving access to the airport.

### **H.5.8 Operational Experience Under Three Regimes**

Keeping in mind numerous factors have influenced the operational experiences of the state, NEG, and the Port Authority -- including those outside the control of the airport operator -- the following table shows a snapshot of the operations under the three regimes. It is also important to note the short history for operation under Port Authority control. Airport development is a lengthy process that is implemented incrementally over many years. (The transition years of 1999 and 2007 were excluded from the analysis because there were two different managers during each of those years.)

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<sup>47</sup> At that time the Port Authority's bi-state charter limited its operations to a zone that extended 25 miles in all directions from the Statue of Liberty. In 1967, lawmakers in Albany passed a bill allowing the authority to have one airport outside that zone in each state. But New Jersey never passed its own version of that legislation until May 3, 2007.

<sup>48</sup> Because the TSA is a separate federal agency, the FAA needed TSA's approval to the security plan as a condition to the sale of the lease.

**Table H.13. SWF Average Annual Performance in Three Time Periods**

	<b>1996-1998</b>	<b>2000-2006</b>	<b>2008-2009</b>
<b>Metric</b>	<b>NYSDOT</b>	<b>NEG</b>	<b>Port Authority</b>
Enplaned Passengers	387,886	205,888	288,987
Cargo Tonnage	1,886	15,368	13,605
Aeronautical Operating Revenue (\$000)	\$2,600	\$2,684	\$3,513
Non-Aeronautical Operating Revenue (\$000)	\$4,601	\$4,799	\$4,586
Total Operating Revenue (\$000)	\$7,201	\$7,482	\$8,099
Total Operating Expenses (\$000)	\$5,953	\$5,967	\$14,757
Operating Revenue Less Expenses (\$000)	\$1,248	\$1,515	(\$6,659)
Total Capital Project Expenditures (\$000)	Not reported*	\$4,929	\$14,423
* Although not reported on the FAA Form 127 data base, the state constructed the 7-gate concourse and ticketing lobby, which opened in 1997, and made other terminal improvements in 1998. Sources: Passengers and Cargo: US DOT Schedules T100 and 298C T1. Financial: FAA Form 127.			

As noted earlier, passenger traffic has been particularly volatile at SWF. A string of airlines have come and gone in both good times and turbulent times. Despite the downturn in traffic that started in 1998 at SWF and accelerated after September 11, 2001, NEG managed to maintain relatively stable aeronautical revenues due to the fixed terminal rents and the growth in cargo landing fees. Although parking and rental car revenues dropped significantly reflecting the falloff in passengers, NEG countered these declines with increases in land and non-terminal rentals. NEG's operating revenues, operating expenses, and net revenue were comparable to those under state operation. In terms of capital improvements, the state opened a new 7-gate passenger concourse in 1997 and in 1998 added concession space, car rental agencies, and other enhancements to the terminal. NEG's capital expenditures at SWF averaged \$5 million per year; however, this was less than the approximately \$10 million per year proposed in its 5-year CIP.

The Port Authority took over operation of the airport in November 2007 just as the global economic downturn was starting.<sup>49</sup> Stewart was hit hard by the recession. Skybus went out of business in April 2008, AirTran exited the airport in September 2008, and the four remaining airlines cut back their schedules. Nevertheless, the Port Authority invested heavily in its first few years of operation relative to NEG in an effort to develop the underutilized facility. For example, operating expenses more than doubled while revenues increased modestly resulting in a negative cash flow for the first two years. In addition, by the end of 2010, the Port Authority was expected to have made about \$50 million in infrastructure improvements. Also, the Port Authority has been in active discussions with air carriers seeking new services at Stewart and implemented an air service incentive program.

The Port Authority's subsidy to the airport, which was funded from other operations, was substantial. After just three years of operation, by November 2010, the Port Authority had:<sup>50</sup>

- Completed a new Federal Inspection Services facility (in preparation for the Mexican charter service that is starting in 2011, and plans to build a permanent facility as part of the upcoming terminal expansion.

<sup>49</sup> The National Bureau of Economic Research announced in December 2008 that the US economy has been in recession since December 2007.

<sup>50</sup> Jamie Simon, *PANYNJ Celebrates 3 Years Since Acquiring Stewart*, Airport Revenue News, November 11, 2010.

- Implemented several parking customer service initiatives, including 800 new parking spaces, pay-on-foot stations in the terminals, an express pay lane, and additional entrances and exits.
- Realigned and rehabilitated roadways, replaced roofs, and improved the taxiway edge lighting systems.
- Added new customer care representatives, new wayfinding signs, baggage carts, extra seating in the baggage-claim and gate areas, and expanded bus service to the Beacon Train Station.
- Put in place a Stewart Sustainability Plan.

### **H.5.9 Lessons Learned**

SWF's entry and exit from the APPP provided a first-of-its-kind experiment and as a result has provided some interesting and instructive lessons, including:

- As demonstrated under other case studies, strong political commitment was necessary to achieve privatization. The reason the initial privatization process succeeded was because Governor Pataki was a strong political champion.
- Navigating through the APPP process takes considerable time and resources. It took 34 months from the time NYSDOT submitted its preliminary application to the FAA until the FAA issued its record of decision approving the transaction. The process included preparing the preliminary APPP application, developing the RFP, evaluating the responses, selecting an operator, drafting and negotiating the complex lease terms, preparing the final APPP application, managing public participation, securing local approvals, and building political support. In considering the timeline, it is important to remember that there are both federal and local requirements. In the case of the SWF privatization, local approvals were required from labor groups, the state attorney general, and state controller, among others. It is important to remember, too, that this was the very first such transaction in the U.S., undoubtedly adding to the length of time required.
- For-profit private companies must make strategic decisions in the interests of their shareholders, which may not always be in the best interests of the airport community. After operating the airport for 7 years, NEG was no longer interested in investing resources in airports. NEG exited the airport industry and concentrated on its core rail and bus businesses. There was no appetite to invest seed money into the airport because NEG was looking for an immediate financial return. As a result, total operating revenue remained flat at best during the NEG operation. NEG fulfilled its lease requirements, but the original enthusiasm and energy for the business waned, and the state was disappointed that additional investments did not materialize. There is no guarantee that the private airport operator will achieve financial success, retain interest in the business, or be successful in its execution. Therefore, the challenge in structuring a successful transaction is to align the interests of the private company with the appropriate incentives.
- NEG paid \$35 million in lease payments and \$10 million in capital contributions at SWF. It did not materially improve SWF's financial performance during its tenure, in part due to the significant cutbacks in air service after September 11, and in part due to the realignment of the company's strategic priorities. It is likely that NEG did not realize the return on its investment as expected during its operation of the airport. In addition, NEG was facing a

5% of gross income lease payment beginning on the 10th anniversary that would further dilute its earnings. NEG sold the lease after 7 years of operation to the Port Authority for \$78.5 million, allowing it to recover its investments and realize a significant capital gain, which was not plowed back into airport improvements.

- One of the intentions of the APPP was to evaluate the potential for new private sector investment in airports through privatization. Indeed NEG invested \$10 million of its own funds into SWF capital development, but it also received a significant return on that investment and its \$35 million lease payment from the sale of the remaining leasehold interest.
- While there was significant economic development associated with SWF during the privatized period, the community's principal goal of improved air service was not achieved. There is only so much a regional airport operator can do to entice sustainable air service. Some believe that the Port Authority has considerably more leverage to entice airline service at SWF due to its control over JFK, LaGuardia, and Newark airports, and its ability under federal law to potentially cross-subsidize the facility. However, this remains to be seen.
- One of the reasons NEG's bid was considered the most attractive was due to its plans to operate express bus service between New York City and SWF similar to the services it operates linking the London airports. It was expected that the SWF bus service would stimulate low fare service from the airport; however, the bus service plan was never implemented.
- SWF was improved on the margin by NEG due to the new leases and commercial development; however, SWF was a problem before, during, and after privatization – enplaned passenger traffic peaked in 1997 at 435,000, troughed in 2002 after September 11 at 170,000, peaked again in 2008 at 446,000, only to crash again in 2009 to 187,000. Neither privatization nor public operation is a panacea for an airport that lacks demand.
- The state's 5-year prohibition from selling the lease worked well. It was designed to prohibit the bidder from flipping the airport for a profit shortly after the transaction.
- The Port Authority has the resources and capacity to make large investments in SWF to implement a long-term vision without expecting short-term financial returns. It does not have to justify its SWF investments and initiatives on a current business basis. As such, the Port Authority has the flexibility to implement a long-term vision of SWF as a significant reliever airport for the greater New York area by making the infrastructure improvements and offering the marketing and financial incentives to achieve this vision.
- The state appeared to be a disinterested absentee landlord owner of SWF during its control of the facility and the Stewart Airport Commission had no governance authority. A more local governance structure, such as ownership by the county, towns, or airport authority, may have been more involved in airport operations and management.

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## H.6 Chicago Midway Airport

### H.6.1 Transaction Background

The proposed long-term lease of Chicago Midway International Airport (“Midway”) to a private firm was by far the largest proposed airport privatization in the U.S. and was posed to be a landmark transaction as the first privatization of a major commercial airport in the U.S. The FAA accepted the City of Chicago’s application in the fall 2006 to reserve one of five spots under the 1996 Airport Privatization Pilot Program (“APPP”) that allows airports to enter into long-term operating leases to private entities. Midway took the one slot allowed for a large hub airport.<sup>51</sup> In addition, the city was the only applicant in the history of the APPP that was able to secure airline approvals for its application, which is needed for the city to use the lease revenues for non-airport purposes.

Midway is a large air carrier hub airport owned and operated by the city and is located about 10 miles southwest of downtown Chicago. Midway encompasses approximately 840 acres and handled 8,468,470 enplaned passengers in 2009. According to ACI-NA, Midway was the 27<sup>th</sup> busiest airport in the U.S. in 2009 measured in terms of passengers. As of October 2010, five airlines provided scheduled passenger service to the airport – AirTran, Delta, Frontier, Southwest, and Porter Airlines (a Canadian carrier). These airlines provide primarily low fare, point-to-point domestic service. As of May 2010, Midway was Southwest’s largest station where it accounted for approximately 85% of the passengers.

The City also owns and operates Chicago O’Hare International Airport, which is the primary airport serving the Chicago area and the 4th busiest in the world measured in terms of passengers (32,047,097 in 2009). O’Hare is located approximately 18 miles northwest of downtown. Midway was the principle airport serving the Chicago area prior to the opening of O’Hare in 1962.

In 2004, the city completed the Midway Terminal Development Program, which included the construction of a new passenger terminal with 3 concourses, 43 gates, and 43,000 square feet of space for concession operations. The new terminal replaced an outdated 27-gate facility. This major redevelopment of the airport was financed primarily with revenue bonds of which a portion is backed by PFC revenues. Midway also has 4 parking areas with over 13,500 parking spaces, including approximately 3,000 in a garage connected to the terminal, and an elevated terminal roadway system.

In addition to the nearly \$1 billion in improvements made by the city for the new, state-of-the art terminal in 2004, the runways were also resurfaced between 1990 and 1997, and an inline baggage screening system was commissioned in 2007. Other than new rental car facility to be financed with Customer Facility Charges (“CFC”), the city identified only “modest” capital expenditure requirements remaining at the time the RFQ was issued in February 2008, including cyclical airfield rehabilitation, soundproofing homes and schools surrounding the airport and improving existing security but no major expansion projects.

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<sup>51</sup> The FAA defines a “large hub” airport as an airport that handles more than 1% of all domestic enplanements.

**Table H.14. Key Traffic and Financial Indicators<sup>52</sup>**

Type of Airport	Origin & Destination (O&D)
FY2009 Enplanements	8,468,470
5-Year Enplanement CAGR 2004-2009	-2.3%
2009 vs. 2008 Enplanement growth	2.9%
2010YTD vs. 2009YTD (July) Enplanement growth	4.8%
% O&D vs. Connecting, 2009 (5 YR AVG)	66.7% (69.7%)
Largest Carrier by Enplanements, 2009 (share)	Southwest (84.9%)
Airline rate-making methodology	Residual
Airline Cost per Enplaned Passenger, 2009	\$9.58
Airline Rates and Charges, 2010 budget	\$82.3 million
Airline Rates and Charges, 2018 forecast	\$130.5 million
CAGR in Airline Rates and Charges – 2010-2018	5.9%
Airline Cost Per Enplanement, 2010 budget	\$11.38
Airline Cost Per Enplanement, 2010 budget	\$14.34
Outstanding Revenue Bond Debt, 2010	\$1,474.1 million
Net Debt Service After PFCs/CFCs/BAB, 2010 budget	\$35.0 million
Net Debt Service After PFCs/CFCs/BAB, 2018 forecast	\$55.7 million
Debt per O&D Enplaned Passenger, 2009	\$189
Bond Ordinance Debt Service Coverage, 2009	1.31x
Days Cash on Hand, YE 2009	411
PFC Rate per enplaning passenger, 2010	\$4.50
CFC Rate per transaction day, 2010	\$3.75

## H.6.2 Objectives

The city began exploring the privatization of Midway Airport soon after it announced its \$1.83 billion 99-year lease of the Chicago Skyway Toll Bridge System in October 2004, a deal considered the first long-term, major public-private partnership involving an existing asset in the U.S. and which closed in January, 2005. Subsequently, the city entered into a long-term lease on its downtown parking garages in a \$563 million deal which closed in December, 2006. In February, 2009, the City also leased its parking meter system for \$1.15 billion. While the Midway privatization was motivated by the success of the Skyway transaction, and both the Chicago Skyway and parking garage transactions proved to be uncontroversial, the unpopularity of the parking meter lease (at least in the early days as discussed in Task 4) may serve to stall the re-launch of Midway.

The primary motivation for the Midway transaction was to get “value out of the airport” by leasing the airport on a long-term basis to a private operator and using the proceeds for the city’s unfunded pension liability, infrastructure improvements, and other general fund purposes. As best expressed by city’s chief financial officer Paul Volpe in a statement:

*“Just as with the long-term lease of the Chicago Skyway, if we successfully conclude this transaction, the taxpayers of Chicago will benefit through a substantial payment to the city that we can use to enhance quality of life for our residents.”<sup>53</sup>*

As stated in the February 2008 Request for Qualifications (“RFQ”), the city’s primary objectives were:

<sup>52</sup> Sources: Moody’s Investor Services, *Moody’s concludes Watchlist and Confirms the A3 Rating on Chicago Midway Second Lien Bonds; Assigns A3 to Series 2010B,C&D Bonds*, Global Credit Research, September 24, 2010; City of Chicago, *Preliminary Official Statement, Chicago Midway Airport Second Lien Revenue Bonds*, September 29, 2010, and other sources.

<sup>53</sup> Yvette Shields, *Chicago Issues RFQ for Midway Airport*, The Bond Buyer, February 14, 2008.

*Protect the Public Interest*

- *Maintain the highest levels of public and passenger safety and security*
- *Protect the public interest within the context of seeking value for the City and the airlines*
- *Establish a new framework of rates and charges that provides lower and more predictable rates for airlines operating at the Airport*
- *Improve the competitive position, service quality, growth prospects and efficiency of Midway Airport for the benefit of Chicago residents, airlines and other users*

*Risk Adjusted Value Optimization*

- *Maximize sale proceeds*
- *Ensure that future Airport development is safe, functional, efficient and delivered when necessary*
- *Minimize the City's exposure to residual risks and liabilities from the process*

*Fair and Transparent Process*

- *Protect the reasonable interests of current and future airline users*
- *Ensure fair and equitable treatment of existing Airport employees*
- *Ensure a smooth transition from public to private management in a timely manner*

### **H.6.3 Transaction Process Summary and Timeline**

**Summary.** In 2005 the city secured state legislation to extend the airport's exemption from property taxes to a private owner, which paved the way for the transaction and committed the city to use 90% of the net proceeds to finance infrastructure work or up to 45% of the net proceeds to shore up the city's \$9 billion (at the time) unfunded pension liability. These commitments were needed to secure the support of the powerful Chicago Federation of Labor. In October 2006, the city secured the only large-hub slot under the APPP. In February 2008, the city secured airline approvals for its APPP and immediately issued an RFQ for bidders. Bids were received on September 30, 2008 two weeks after Lehman Brothers Holdings collapsed (September 16), which triggered the global credit crisis. When the private consortium was unable to come up with the full up front rent payment under the lease (purchase price) of \$2.521 billion in April 2009, the deal fell through and the consortium had to pay a \$126-million breakup fee to the city, of which \$75 million had been posted as collateral after city council approved the lease. Since that time, the FAA has granted the city's requests for more time to complete the deal through a series of extensions to maintain its spot in the APPP. In its January 2010 filing, the city told the FAA that it "intends to complete the privatization process at the earliest practical date" but noted that "the pace and direction continues to be dictated by conditions in the global credit and capital markets." The city indicated that talks could resume with the highest bidder or other qualified bidders, or the city could put the airport out for bid again.

**Timeline.** A summary of the transaction timeline is as follows:



**Table H.15. Chicago Midway Airport Privatization Timeline**

2005	City engaged Chicago Federation of Labor in discussions regarding the privatization.
May 9, 2006	Illinois governor signed legislation allowing the extension of the property tax exemption to a private owner, thereby allowing the city to lease Midway Airport for maximum value.
September 16, 2006	City submitted its preliminary application for participation in the APPP to the FAA.
October 3, 2006	FAA accepted MDW's preliminary application.
October 2006	City started negotiations with the airlines on an agreement.
November 15, 2007	City and Southwest Airlines sign memorandum of understanding
February 13, 2008	City solicited request for qualifications (RFQ) from interested operating firms or investment groups. The interested parties provided documentation that described their qualifications to serve as the airport sponsor.
February 13, 2008	City and airlines concluded negotiation of a 25-year Airport Use Agreement
March 31, 2008	City received six responses to the RFQs.
September 30, 2008	City selected Midway Investment and Development Corporation ("MIDCo") to operate the airport under a 99-year lease. The consortium comprised Vancouver Airport Services Ltd., Citi Infrastructure Investors, and John Hancock Insurance Company. The City will receive an initial payment of \$2.521 billion for the right to lease the airport.
October 8, 2008	Chicago City Council agreed to the \$2.521 billion deal to lease Midway Airport to a private operator and the city executed the Concession and Lease Agreement (CLA) with MIDCo.
October 14, 2008	FAA received Midway's final application for review and approval.
October 21, 2008	60-Day Public Comment and Review Period began.
November 8, 2008	FAA held a public meeting in Chicago to receive public comments.
December 22, 2008	Public Comment Period closed. The FAA announced plans to complete its review of the application by the end of this year.
January 12, 2009	FAA issued a statement saying that the final review of the privatization application cannot be completed because critical financial documents have not been submitted. The statement says that Midway Investment & Development Company LLC plans to finalize its financial agreements with plans to close on or about April 1.
April 1, 2009	FAA granted its 1st extension to the City to provide additional information.
April 6, 2009	The original closing date for investors to secure financing is pushed back six months so investors can have more time to raise the necessary finances
April 20, 2009	City terminated the CLA with MIDCo because of its inability to finance and make the upfront rent payment.
February 1, 2010	FAA granted its 2nd extension to the City to provide additional information.
April 30, 2010	FAA granted its 3rd extension to the City to provide additional information.
July 31, 2010	FAA granted its fourth extension to the City to provide additional information.
November 30, 2010	City must provide an update to the FAA on its progress

#### H.6.4 Stakeholder Approvals

**Labor.** The city won the support of unions by ensuring that current employees would be offered jobs with similar pay and benefits in any lease. The city's commitment to use the net proceeds to fund pensions and infrastructure also helped. The Illinois legislation that allowed the city to lease Midway requires the private operator to pay employees "an amount not less than the economic equivalent of the standard of wages and benefits enjoyed by the lessor's employees who previously performed that work." In addition, the private operator and the city must offer employment "under substantially similar terms and

*conditions*” to municipal employees working at the airport. There is also a labor neutrality and card check agreement covering unrepresented workers.<sup>54</sup>

**Community.** In order to maintain Midway's property tax-exempt status under private operation, the city had to negotiate with the state legislature. The tax-exempt status was considered necessary for the transaction to be economically viable and as such was a front-end activity. In addition to the labor protections noted above, the state legislation also:

- Required that at least 90% of the proceeds from the lease be used for infrastructure construction and maintenance and for contributions to the municipal employee pension funds.
- Prohibited the expansion of any of the Midway runways.<sup>55</sup>

In its final application, the city reported its efforts to consult with airport users and its efforts at community outreach as follows:

**Table H.16. Chicago Midway Community Outreach**

<b>Date</b>	<b>Meeting</b>	<b>Subject of Meeting</b>
April 24, 2008	Midway Noise Compatibility Commission	Briefing on the Lease
June 24, 2008	Concessionaires, FBOs and rental cars agencies	Briefing on the Lease
May 2, 2008	Chicago Convention and Tourism Board	Briefing on the Lease
September 4, 2008	Chicago-Gary Regional Airport Authority	Briefing on the Lease and concerning the impact of proposed transaction on the Chicago-Gary Airport Interstate Airport Compact
Second Wednesday of each month	Monthly meeting of Midway Airport that includes concessionaires, fixed base operators and others involved in airport operations	Briefings on the Lease
October 6 and 7, 2008	Chicago City Council Committee Meetings	Consideration and approval of Lease
October 8, 2008	Chicago City Council Meeting	Consideration and approval of Lease
November 8, 2008	FAA Public Hearing	APPP Application

At the public hearing for the APPP application, there was only one question raised by the public. This person wanted to make sure that general aviation would continue to be accommodated at

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<sup>54</sup> In 2006, the Illinois General Assembly enacted Public Act 94-750, which provides for certain requirements that must be satisfied in connection with the privatization of Midway. These requirements relate to labor relations and employee protections; continued compliance with applicable ordinances governing contracting with minority-owned and women-owned businesses, prohibiting discrimination and requiring appropriate affirmative action; and application of the net proceeds of the privatization by the city.

<sup>55</sup> The airport is located in a densely developed section of the city, including residential development. Also, in December 2005, a Southwest Airlines aircraft slid off a runway at Midway while landing in a snowstorm and crashed into automobile traffic, killing six-year-old boy.

Midway. The meeting was adjourned after no other questions taking only 25 minutes, which were almost entirely presentations.

**Airlines.** Under the APPP, in order for the city to apply lease revenues from the transaction for general city purposes, the lease must receive the approval of both 65% of the airlines operating at Midway and airlines representing 65% of the annual landed weight. This provision gave all Midway carriers, especially Southwest with 84.4% of the passenger market share in 2008, considerable bargaining power.

After being accepted under the APPP by the FAA in late 2006, the city began negotiations with Southwest Airlines. Southwest's vice president of properties, Bob Montgomery, admitted to having a "healthy skepticism" of the privatization because he was concerned that the city's goal was to sell a long-term interest in the airport with little concern for the interests of airlines or passengers. However, because the city had been a "good partner," Southwest agreed to the talks with the city. Montgomery said:

*"We were concerned. We investigated the European model and its problems because it doesn't result in lower costs and developed a laundry list we thought we needed to resolve. We also felt that Midway was already so well-run by the city and we had just successfully finished expansion projects. We didn't want to mess it up. The city did great work in listening to us and coming up with creative solutions."<sup>56</sup>*

The transaction stalled as Southwest sought to leverage its position as the top airline at Midway to gain a share of the transaction's profits and secure other favorable financial terms. After the city shared an outline of the financial details of a possible lease that included controls on rate increases, Southwest hired Citibank to analyze the plan. Subsequently Southwest sent a letter to the city in February 2007 stating that *"While new information could change our minds, presently we believe that privatization is threatening to the interests of [Midway] and the airlines and passengers who rely upon it."*

Eventually, Southwest dropped its request for a share of the profits, but secured an agreement that would generate millions of dollars in net present-value savings for itself and the other airlines serving Midway. Specifically, the deal won airline approval because it would:

- Cap airline rates and charges at a level below total 2008 charges and freeze rates for the first six years. It should be noted that the residual airline rates that were in effect at that time did not include amortization of principal on the bonds issued to finance the terminal redevelopment. Therefore, the airlines would have been able to lock in very favorable rates before they spiked. Airline cost per enplanement (CPE) ranged from \$3.38-\$7.55 from 2004 - 2009, with the high occurring in 2009. However, the budgeted CPE in 2010 increased sharply to \$11.39, which had been planned due to the deferral of principal amortization and expiration of the application of Letter of Intent grants to debt service. The airport also projected CPE to increase sharply again in 2011, to \$14.63, but remain near that level through 2018.
- Limit future rate increases to inflation for the remainder of the 25-year use agreement.
- Grant the airlines approval rights for capital improvement costs to be included in airline rates (i.e., the cost of ongoing capital projects would be added to annual airline charges only after airline approval).

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<sup>56</sup> Yvette Shields, *Airports Poised for Privatization*, The Bond Buyer, June 18, 2008.

- Provide strong operating and service performance standards, including a capital asset maintenance plan, capital improvement program report, and five-year capital improvement program that must be developed on an annual basis by the private operator and submitted to the city and the airlines for approval by the city and a majority in interest by the airlines. These reports would define and describe the planned rehabilitation, replacement, and reconstruction capital requirements
- Transfer the risk of operations and maintenance costs from the airlines to the private operator.
- Give the airlines sign off rights on the bidders' qualifications.

Not only would the transaction have provided the airlines considerable net present value savings (especially in the near term), but it would have also would have provided stable, predictable rates and charges, which is one of the airlines' biggest concerns. Under the existing residual ratemaking methodology, airline rates and charges can vary based on external events outside the control of the city (e.g., amount of service provided by the airlines) and airlines (inflation, unfunded government mandates, etc.).

The airlines also wanted to maintain the Midway Airlines Terminal Consortium (MATCO), which was formed to operate and manage the terminal airline equipment and systems, including pre-conditioned air systems, aircraft ground power-400Hz system, passenger loading bridges, potable water cabinets, baggage handling systems, MUFIDS, battery charging, security checkpoint equipment, and aircraft fueling systems.

In February 2008, the city reached a preliminary agreement with 5 of the 7 airlines serving Midway at the time – Southwest, Delta, AirTran, and ATA (which pulled out of Midway a few months later) and Frontier, which together accounted for 97% of the passengers. At the time the final application was submitted in October 2008, 4 of the 5 airlines then serving the airport (Southwest, Delta, AirTran, and Northwest) had signed and approved the Airport Use Agreement. Only Frontier had not signed the Airport Use Agreement (even though it signed the preliminary understanding and expressed support for the transaction) because it was in bankruptcy at the time and had not yet received approval from the bankruptcy court to sign the agreement.

Bob Montgomery announced: “*With the city, Southwest welcomes the opportunity to increase our collective knowledge about airport privatization in a manner that hopefully produces a mutually beneficial outcome for both the city and the airlines.*” The use agreement would have extended through 2033, with five-year renewals afterward. The current agreement expires in 2012.<sup>57</sup> The Southwest representative leading the negotiations, Amy Weaver, commented:

*“The [proposed Midway privatization] deal was a win-win for both the airport and the airlines. Airlines are the key value drivers at MDW, and we believe the deal addressed our fears. We negotiated guarantees that controlled costs and protected operations. And, the City of Chicago was able to get the assurances needed, as well. As we negotiated the agreements, the city and the airlines collaborated to address their respective concerns, so that both sides felt comfortable moving forward. . . . Even though privatization has not happened at MDW yet, I believe privatization in America will fly. The process to privatize MDW worked on all levels—airport, airlines, city government, and federal government. It has set the pace, process, and expectations for future U.S. privatization discussions.”<sup>58</sup>*

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<sup>57</sup> Yvette Shields, *Chicago, Southwest Reach Preliminary Lease Understanding*, The Bond Buyer, November 16, 2007.

<sup>58</sup> Amy Weaver, *Southwest Airlines says Midway indicates privatization can fly in the United States*, HNTB Aviation Insight, Spring 2010.

Erin O'Donnell, Managing Deputy Commissioner of Chicago Midway International, said the transaction would not have happened without Southwest Airlines in charge because Southwest was "able to think outside the box."<sup>59</sup>

**General Aviation.** As required under the APPP, and as reflected in the proposed lease with MIDCo., the percentage increase in fees imposed on general aviation aircraft could not exceed the percentage increase in fees imposed on the Midway air carriers.

**Potential Bidders.** The city also met several times with potential bidders to learn about their interests and concerns to design a solicitation that met their needs. Through these discussions, it was determined that the city would need to maintain the police and fire functions for Midway to mitigate the risks perceived by the potential bidders.

### H.6.5 RFQ Highlights

After receiving airline approval for the lease with the 5 airlines, the city released its RFQ to companies or teams interested in competing for the long-term concession and lease under the terms agreed to by the airlines. Highlights of the proposed RFQ included:

- The private operator would be granted the exclusive right to operate Midway and to collect all revenues associated with the operation of the airport, including aeronautical, concession, rental car customer facility charges, passenger facility charge ("PFC") revenues and federal grants, subject to restrictions imposed by the FAA.
- As per the state legislation, private investors who lease Midway would be guaranteed property tax exemptions; however, runways could not be expanded beyond the current boundaries and all city workers directly employed at Midway must be offered substantially similar jobs at comparable pay.
- The private operator would have to comply with the city's minority-owned and female-owned business (MBE/WBE) requirements and applicable federal disadvantaged business enterprise (DBE) participation requirements, in its contracting activities during the term of the lease.
- The Chicago Police Department would continue law enforcement activities and the Chicago Fire Department would still have responsibility for fire, medical, and other airport emergencies.
- The private operator would also be bound by all the conditions provided under the 25-year Airline Use Agreement, including those noted above.
- The proposed term of the lease was "at least 50 years."<sup>60</sup>
- The city would be responsible for completing certain capital projects and the private bidder would be responsible for all other capital expenditures for the term of the lease.

The \$4.50 PFC per enplaned passenger is currently used to offset debt service before calculating annual rates and charges. The PFC would be permitted to be collected by the private operator (even though the revenue bond debt would be retired by the city.) Regarding PFCs, the city said in its final application:

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<sup>59</sup> Remarks during panel entitled *Destination Privatization: The Future of Public/Private Partnerships* at the AAAE National Airport Conference in San Diego, September 21, 2010.

<sup>60</sup> In the final bid solicitation document, the lease term was fixed at 99 years.

*“The City is requesting that all of its PFC collection and use authority at Midway...be transferred to MIDCo. MIDCo will apply PFCs collected under this authorization to pay debt service on approximately \$820 million principal amount of indebtedness incurred by MIDCo and that will refinance an equivalent principal amount of bonds previously issued by the City to finance PFC-approved projects at Midway. The City will file an amendment to its existing PFC application to provide for the use of such PFCs to pay MIDCo debt in the foresaid amounts in accordance with the terms of the new MIDCo debt.”*

### **H.6.6 Qualified Bidders**

Six groups interested in competitively bidding to enter into a long-term lease for Midway submitted qualifications:

- Abertis Infraestructuras SA of Barcelona, Spain, Babcock & Brown Group of Sydney, Australia, and GE Commercial Aviation Services of Stamford, Conn.
- AirportsAmerica Group, consisting of Carlyle Infrastructure Partners LP of Washington, D.C.
- Chicago Crossroads Consortium, consisting of Macquarie Capital Group Ltd. and Macquarie Airports of Sydney, and Macquarie Infrastructure Partners and Macquarie Infrastructure Partners II of New York.
- Chicago First Consortium, consisting of HOCHTIEF AirPort GmbH and HOCHTIEF AirPort Capital GmbH & Co. of Essen, Germany, and GS Global Infrastructure Partners I LP (an investment fund run by Goldman Sachs) of New York.
- Midway Investment and Development Corp., consisting of YVR Airport Services Ltd. Of Vancouver, Citi Infrastructure Investors of New York, and John Hancock Life Insurance Co. of Boston.
- Morgan Stanley Infrastructure Partners of New York, Aeroports de Paris Management of Paris, and HMSHost Corp. of Bethesda, Md.

The city eliminated one of the six teams that had submitted qualifications and two teams decided to withdraw, leaving three teams expected to submit bids: Chicago First Consortium, Midway Investment and Development Corp., and Morgan Stanley/Aeroports de Paris.

There was strong interest in Midway from Australian and Canadian retirement funds as well as international infrastructure funds. As described in more detail in Appendix G, airports and other infrastructure assets fit the long-term investment criteria for retirement and infrastructure funds due to the stable returns and low inflation risk.

### **H.6.7 Winning Bidder**

The consortium of investors led by Citigroup Inc., a unit of Vancouver International Airport, and John Hancock Life Insurance Co. submitted the highest bid (\$2.521 billion) to lease Midway. The winning consortium was called Midway Investment and Development Company LLC (“MIDCo”). The city did not disclose the size of bids from the other pre-qualified bidders or how many were submitted. However, it was rumored that the \$2.521 billion bid was considerably higher than the second-best offer.

At first some city council members expressed concern that the asset could attract more interest and a higher bid during a stronger economic cycle, but the city’s CFO, Paul Volpe, reassured city council

with comparisons of earnings ratios. In particular, Volpe said MIDCo's bid equaled roughly 28 times the annual earnings ratio of Midway -- a level that "exceeded" the city's original expectations two years earlier when the finance team was assembled. He said it also exceeded the 23 to 24 earnings multiple generated in other recent overseas airport transactions. The city council voted 49-0 to approve the lease agreement.

Under terms of the lease, MIDCo was required to post \$75 million in "earnest money" initially, which increased to 5% of the transaction, or \$126 million, when city council approved the lease.

The city said it planned to use the \$2.521 billion as follows:<sup>61</sup>

- \$1.196 billion would be used to retire or defease outstanding Midway revenue bonds, pay for transaction costs and expenses, and pay a portion of the capital costs for projects the city agreed to complete (including land acquisition, residential sound insulation)
- \$225 million would be deposited into a fund that together with associated interest earnings would be used to fund police, fire, and emergency services to be provided by the city at Midway
- The remaining amount (approximately \$1.1 billion) would be used for general city non-airport purposes

The city would also transfer certain operating reserves to MIDCo. For example, regarding the PFC revenues from the \$4.50 per enplaned passenger PFC, MIDCo said approximately \$50 million of existing PFC reserves would be transferred from the City to MIDCo and the PFC revenues would be used for debt service on \$820 million of debt and FAA-approved projects. In addition, the \$3.75 per car rental day Customer Facility Charge (CFC) would be used for capital expenditures for a new Consolidated Car Rental Facility ("CCRF") and operating costs for the CCRF. The city would transfer the approximately \$20 million of existing CFC reserves to MIDCo.<sup>62</sup>

MIDCo, which was a Delaware limited liability company, was comprised of the following equity sponsors:<sup>63</sup>

- 89.34% owned by Citi Infrastructure Partners, LP ("CIP"), a fund managed by Citi Infrastructure Investors ("CII") – the infrastructure investment center within Citi Alternative Investments ("CAI"). CII is a United Kingdom investment partnership managed by a wholly-owned, indirect US subsidiary of Citigroup Inc., the U.S. based global financial services company ("Citi"). A wholly-owned US subsidiary of Citi is the manager and general partner of CII, and a number of institutional limited partners are passive investors in CII.
- 2.91% owned by YVR Airport Services Ltd. ("YVRAS"), which is a Canadian subsidiary of and equally owned by the Vancouver Airport Authority ("YVRAA") and CIP Airports, LP (an affiliate of CII).
- 7.75% owned by John Hancock Life Insurance Co. (JHLI) – a \$60 billion investment portfolio managed in Boston, with 10% dedicated to transportation. JHLI is an indirect, wholly-owned US subsidiary of Manulife Financial Corporation, a publicly-traded Canadian corporation.

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<sup>61</sup> City of Chicago, *Second Supplement to the Final Application*, March 5, 2009.

<sup>62</sup> MIDCo, *FAA Presentation -- Chicago Midway International Airport*, December 12, 2008.

<sup>63</sup> Id.

MIDCo planned to enter into a long-term management advisory services agreement with a wholly-owned US subsidiary of YVRAS.

In a presentation to the FAA in December 2008, MIDCo disclosed how it planned to make the upfront payment of \$2.521 billion due to the city upon the financial closing:<sup>64</sup>

- MIDCo’s capital structure will include third party senior bank debt and shareholder capital (comprised of a combination of subordinated debt loaned to MIDCo by its members and cash contributions of ordinary equity provided by MIDCo’s members)
- Shareholder capital will comprise at least 50% of MIDCo’s initial capital structure
- Under the debt financing documents, all available revenues (excluding revenues PFC revenues and grant monies which are restricted by their terms for other specific purposes) will be applied in the following priority of “waterfall payments”:
  - first, to pay operation and maintenance expenses, capital expenditures, certain general and administrative expenses, and amounts necessary to replenish previously tapped reserve funds to their required levels, among other things;
  - second, to make interest payments when due on MIDCo’s senior debt, including interest rate hedge obligations with respect to such debt; and
  - third, to prepay principal on MIDCo’s senior debt with certain of any remaining excess revenues
- Only after satisfaction of the required “waterfall payments” could MIDCo use any further remaining excess revenues to make payments in respect of the shareholder capital
- MIDCo’s senior and subordinated debt will be secured by a pledge of its interest in the Concession and Lease Agreement (CLA), among other things

### **H.6.8 The “Secret Sauce”**

A number of people have expressed skepticism on the ability for MIDCo to be able to make a profit given the amount of the bid, the rate caps under the airline use agreement, the relatively well-developed terminal retail program, the operating efficiencies introduced by the city in 2009, the limited potential for land development, and limitations on passenger throughput growth due to the prohibition on runway expansion and lack of land for terminal expansion. When asked about this issue, YVRAs commented “that’s the secret sauce.” During a presentation to the FAA, MIDCo said operating expense savings were expected to come from the following:

- Lower costs for shared services presently provided by the city – MIDCo anticipated its costs for providing these services would be less
- Reduction in amortization costs because MIDCo planned to buyout certain equipment
- Energy savings based on technical advisors report and operations review
- Savings on insurance costs based on a quote from Aon
- Contractual efficiencies
- Efficiencies on procurement and purchasing functions
- Elimination of privatization process costs and certain other costs historically expensed and not capitalized by the city

MIDCo also said revenue enhancements were expected to come from:

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<sup>64</sup> Id.



- Expansion of concession facilities in the central triangle, retail street walkway, check-in hall, pre-security and in baggage claim areas, and various other locations throughout the terminal and outside
- Opportunity to rationalize underperforming stores and new offerings
- Better management of the concession program, including pricing and promotion programs, brand and promote the retail experience, and monitoring the experience and coaching underperformers

Aeronautical revenues would consist of:<sup>65</sup>

<b>Airline Base Contribution</b>	\$45mm per year based on the Airport Use Agreement
<b>MATCO Revenues</b>	Revenues based on pass through of operating costs for common-use airline equipment such as bridges, FIDS, fuelling system fees, etc.
<b>Other</b>	Hangar and FBO leases based on long term leases between MIDCo and tenants
<b>Airline CapEx Recovery Contribution</b>	Revenues based on recovery of the MII approved capital program in line with Airport Use Agreement

As noted earlier, job security for all Midway employees was an important objective for the city. Therefore, MIDCo was required to offer jobs to all of the 240 direct Midway employees, of which approximately 95% were represented by collective bargaining agreements. The offer must be no less than the current salary, but the private operators were not expected to match the city’s relatively robust benefit plan. For any employee that declined, the city was obligated to find a job in its roughly 30,000 person work force. It was estimated that 18% of the employees said they would take the MIDCo offer. Most of these were employees who were already locked into the Chicago pension plan. Those that were close to retirement wanted to stay with the city.

### **H.6.9 Global Credit Crunch Prevents Financial Closing?**

In the context of the global financial crisis, MIDCo was unable to raise the entire purchase price for the lease by the city’s deadline in April 2009, and as a result forfeited the \$126 million in earnest money it posted to the city. Citi disclosed that financing was expected to consist of about \$1 billion in equity (90% from Citi, 7.5% from John Hancock and 2.5% from YVRAS), about \$800 million in bank debt, and the balance to come primarily Citi's limited partners, who had rights of first refusal. The LPs, which included the Alaska Permanent Fund Corp., the Abu Dhabi Investment Council and the Netherlands' PGGM, said they ran out of allocatable capital due to the dramatic drop in the equity markets by the time of the financial closing in April 2009. An attempt to fill the gap with convertible instruments failed to attract takers.

Speculations on why the deal collapsed range from it being just another victim of poor credit markets to there being a problem securing the equity given the aggressive bid price. Nevertheless, it would appear that that the highly leveraged environment that existed before the global markets collapsed had fueled unrealistic prices and expectations for some underlying assets whose values

<sup>65</sup> Id.

have since waned, including Midway. As noted earlier, the \$2.52 billion bid translated into an EBITDA multiple of 28x and might now be viewed as a high-water mark for airport valuations in the U.S. London City Airport achieved a 30x multiple on the sale to GIP/AIG in 2007 and the failed 40x multiple valuation of a 60% stake in Auckland International Airport by Dubai Aerospace Enterprise also in 2007 was the highest ever and an outlier.

The city applied the \$126 million breakup fee as follows:

- \$13 million was used to reimburse the city for costs associated with the privatization process
- \$33 million redeemed general obligation debt of the city
- \$40 million was transferred to the city's corporate fund
- \$40 million was transferred to a reserve fund to be paid to the city's corporate fund in equal amounts for 2010 and 2011

### **H.6.10 Next Steps**

The city must file quarterly reports in order to retain its hub privatization slot under the FAA's pilot program. In its supplemental filings with the FAA on January 29, 2010 and most recently on July 30, 2010, the city said:

*“The City is in continuing deliberations regarding the completion of the Midway Airport privatization. The pace and direction continues to be dictated by conditions in the global credit and capital markets. The City intends to complete the privatization process at the earliest practicable date. The City will report back to the Federal Aviation Administration by November 30, 2010 on further developments with respect to the process to select a private operator.”*

In October 2010, the city issued \$251 million of second-lien Midway International Airport bonds to refund outstanding commercial paper and wrap up financing for a new consolidated rental car facility. The 2010 bonds were structured to pay interest only through 2015 with principal amortization beginning in 2016 to minimize the near-term impact of the new debt on airline costs. The structure was also designed to leave the city flexibility in the event it resurrected plans to privatize the airport.<sup>66</sup> By the time the 2010 bonds were sold in October 2010, traffic had recovered materially since its slump in 2008. Midway was one of a few airports in the nation to experience traffic growth in 2009 (2.9%), and traffic had increased nearly 5% for the first 6 months of 2010.

As of September 2011, Chicago retains its slot with the FAA. Although Mayor Daley said he wanted to resurrect the deal when market conditions improved, he decided not to seek re-election (in February 2011) and not pursue a Midway lease for the balance of his remaining term. Chicago's new Mayor Rahm Emanuel wants to leave the door open to the Midway privatization and has asked the FAA to preserve its approved slot under the pilot program. Emanuel has said a number of times that he has no plans to try again — at least in the near term — to pursue a Midway lease. He also said that he wants a strict policy on future leases in place before considering any future leases. Nevertheless, the city submitted the required application to preserve the spot by the July 31 deadline. According to a spokesperson for the Mayor:

“The mayor believes that any monetization of the city's assets must meet an extremely high threshold to ensure it benefits the taxpayers. His view on this has not changed. The mayor has no

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<sup>66</sup> City of Chicago, *Preliminary Official Statement, Chicago Midway Airport Second Lien Revenue Bonds*, September 29, 2010.

plans to resurrect [the Midway lease] in the short term until we establish an open process and can ensure all revenue generated from the deal is protected for long-term investment.”<sup>67</sup>

If so, it is unknown whether the ultimate deal will be different than the one that nearly was inked.

### **H.6.11 Lessons Learned**

People involved with the Midway transaction trumpeted its merits and “win-win” proposition to all stakeholders. They believe the only reason the transaction failed to reach financial close was due to the collapse of the debt and equity markets.

Others have expressed concerns about the precedents set in terms of the amount of the bid proposal of the winning bidder and the favorable provisions in the airline agreement. They fear that other policy makers will expect to realize the same multiples (28 times revenues) and that the airlines will see the Midway lease as the benchmark for future privatization transactions even though the conditions are different for every airport.

The lessons learned from this transaction include:

- A successful APPP application process requires strong political support and leadership. The city of Chicago had that in Mayor Richard M. Daley. There was also a very supportive administration in Washington, D.C., and there was political momentum from the large bid on the Skyway deal.
- Going through the APPP is a lengthy, complex, and time-consuming, process and can be an expensive process. The rewards to the airport owner can be potentially large, but success is not guaranteed. Any public sponsor should consider the level of effort, expense, and risk before applying
- Privatizing an airport under the APPP in the U.S. is far more complicated than privatizing toll roads or parking facilities given the highly regulated environment, complexities involved in operating an airport, the pace of technological changes affecting airports, and the multiple approvals needed -- including the FAA, TSA, Committee on Foreign Investment in the United States (if the sale or lease of the airport is to a private operator that is a foreign entity<sup>68</sup>), labor, and airlines (if revenue is to be used for non-airport purposes) in addition to the local approval requirements (e.g., city council).
- It is important to include in the airport’s privatization team technical advisors given the extensive and complex legal, financial, operational, and regulatory issues involved in the airport industry. The city had very capable external advisors and engaged airport staff productively in the operational issues.
- The goals for the privatization should be clearly articulated. The city’s goals were always transparent and well-articulated, which helped eliminate resistance to the transaction.

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<sup>67</sup> Yvette Shields, *Chicago's Emanuel Wants FAA to Leave Program Slot Open*, The Bond Buyer, August 8, 2011.

<sup>68</sup> Due to the lack of airport privatization in the U.S. most of the potential bidders tend to be global infrastructure specialists.

- It is important to estimate the expected net proceeds early in the process to know if the transaction can yield positive benefits. The city retained financial advisors to run various scenarios to assist it in making the decision to go forward with the transaction.
- The public sponsor needs to get key stakeholders on board early, including labor and airlines, to maximize the potential for success.
- Transparency and public outreach are important. The FAA sets up public dockets that contain valuable information, but local residents often are not aware of this resource. In the case of Midway, where homes are as close as 30 feet from the airport boundary, the local community was very supportive because the local community understands the economic value of the airport.<sup>69</sup>
- Maintaining property tax exemptions under private operation of a long-term lease is important for the economics of the deal or would otherwise need to be reflected in the valuation of the airport.
- Oversight and performance standards are important to include in the operator's concession lease and they should be coordinated with the airlines. The operator must be held accountable.
- The length of a lease needs to be considered carefully. Initially it was expected that the Midway lease would be for "50 years or more" as U.S. accounting rules dictate that, for expenses to be deducted by the lessee, the length of the lease needs to equate to the remaining economic life of the asset, and this deal that was approved for a term of 99 years to maximize the up-front lease payment to the City. The level of equity investment is tied to the term, which falls off dramatically with shorter terms. On the other hand, with long-term leases it is important to ensure the operator does not neglect the asset in the final years of the lease. This is why the Midway operator was required to prepare a capital asset maintenance plan, capital improvement program report, and five-year capital improvement program each year and submit them to the city and the airlines for approval.
- The city was not in a position to offer tax-exempt financing to the bidders, which is one way to substantially lower the amount of financing needed by private investors (as shown in the JFK IAT case study). This is because in order to qualify for the federal tax exemption, the asset must be governmentally owned, which means the term of the lease cannot be greater than 80% of the useful life of the asset. As noted above, privatization models push for longer terms. In addition, under IRS regulations, tax exempt bonds cannot be used to acquire existing assets unless at least 15% of the proceeds are used for rehabilitation expenditures for buildings associated with the property.<sup>70</sup>
- Privatization through the APPP is not a solution for every airport. It was used by the City of Chicago because it allowed for the net proceeds paid up-front under the lease to be used "off airport." However, and as best expressed by Amy Weaver of Southwest Airlines who participated in the Midway transaction "The APPP outlines a practical, effective process for privatization. Airports, airlines and any other players need to remember that each privatization deal is unique...The pilot program is flexible enough to accommodate...unique

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<sup>69</sup> Interview with Erin O'Donnell, Managing Deputy Commissioner of Chicago Midway International, September 20, 2010.

<sup>70</sup> 26 USC 147 - Sec. 147. Other requirements applicable to certain private activity bonds.

qualities.”<sup>71</sup> One of the reasons the airline rates could be frozen for the first six years at Midway was because the city had just completed a major terminal redevelopment program and the APPP rules provides airlines with negotiating leverage.

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<sup>71</sup> Amy Weaver, *Southwest Airlines says Midway indicates privatization can fly in the United States*, HNTB Aviation Insight, Spring 2010.

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## H.7 Morristown Municipal Airport

### H.7.1 Airport Background

Morristown Municipal Airport (MMU) is a general aviation airport that is owned by the Town of Morristown and has been managed and developed by DM AIRPORTS, LTD. (“DM”), an affiliate of the DeMatteis Organizations, since 1982 under a comprehensive long term lease. It is located in Hanover Township in Northern New Jersey at the intersection of Route 24 and Columbia Turnpike. DM promotes that MMU is “27 stoplight-free miles to Manhattan” and 18 miles from Newark Liberty International Airport (“EWR”) to highlight its proximity to New York City.

MMU is the second busiest public-use general aviation (“GA”) airport in the State of New Jersey. It serves all types of GA activity including business/corporate, recreational, and flight training, as well as many leading New Jersey and national corporations, such as Honeywell. MMU is designated as a reliever airport by the FAA in its National Plan of Integrated Airport Systems (NPIAS). Under this designation, the airport serves as an alternate facility for GA traffic that would otherwise operate at EWR, thereby enhancing capacity, safety, and efficiency at EWR. As such, MMU is a key component of the New Jersey transportation system, and an important contributor to local, regional, and statewide economic development.

The airport occupies 637 acres and has two runways -- Runway 5/23 (5,998 feet x 150 feet) and Runway 13/31 (3,997 feet x 150 feet).

**Figure H.6. Morristown Municipal Airport**

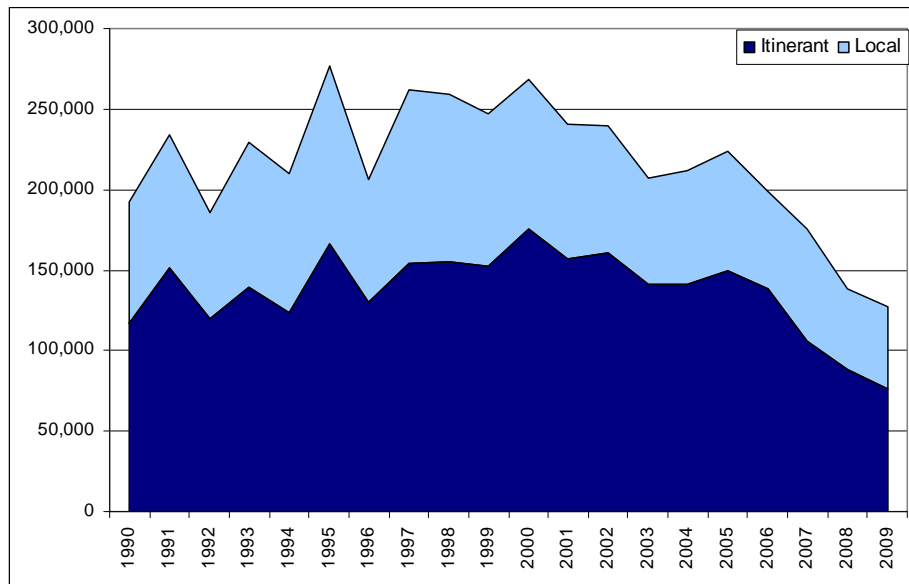


*Photo: Courtesy of DM AIRPORTS LTD.*

MMU provides services for businesses located in Morris County. Approximately 50 of the nation's Fortune 500 companies are either headquartered or have major facilities in the county. Major area employers include: Accenture, ADP, AT&T, Atlantic Health Systems, Automatic Switch Company, BASF, Bayer Consumer Care, , Deloitte & Touche, Honeywell, Howmet (an Alcoa business), Jersey Central Power & Light, Johnson & Johnson, Kraft Foods, Novartis, Pfizer, Inc, PricewaterhouseCoopers, Realogy Corporation, State Farm Insurance, Transistor Devices, Inc., Tiffany & Co., United Parcel Service (UPS), Verizon, Wyndham Worldwide, and Wyeth. Morris County provides a prime location within close proximity to New York City and MMU provides all the aviation amenities required to maintain a flight department.

In 2009, MMU handled 127,224 aircraft operations, with the majority being itinerant. As shown in Figure H.7, there has been an almost steady decline in aircraft operations since 2000, reflecting the impact of the terrorist events of September 2001, the economic recession, increases in fuel costs, and the national decline in general aviation activity. In particular, the decline in aircraft operations reflects declines in flight school activity.

**Figure H.7. Aircraft Operations at Morristown Municipal Airport**



Source: Federal Aviation Administration Terminal Area Forecast, December 2009, and FAA monthly operations for calendar year 2009.

Similarly, the number of aircraft based at MMU peaked in 1995 at 416 and has declined almost steadily since that time also reflecting national trends. However, DM expects that the number of based aircraft has stabilized. Although MMU caters to all types of general aviation, there is a relatively high proportion of high-end general aviation aircraft based at MMU as shown in Table H.17.



**Table H.17. Based Aircraft at Morristown Municipal Airport**

	Single	Multi	Jet	Helo	Turbo	TOTAL
West Tie Down	75	5	0	0	0	80
Private Hangars	39	10	7	2	3	61
Corporate Tenants	31	1	58	8	4	102
<b>TOTAL</b>	<b>145</b>	<b>16</b>	<b>65</b>	<b>10</b>	<b>7</b>	<b>243</b>

Source: DM AIRPORTS LTD. September 2010.

MMU competes primarily with Teterboro Airport and Westchester County Airport for business. Teterboro Airport is also a general aviation reliever that is owned and operated by the Port Authority of New York and New Jersey and located approximately 12 miles from midtown Manhattan in the New Jersey Meadowlands. Westchester County Airport is located in White Plains, NY along the border between Westchester County and Greenwich, CT. In addition to servicing scheduled commercial passenger service, Westchester County Airport is one of the most active business aviation facilities in the county. As a result, DM is highly incentivized to provide strong customer service at reasonable prices to its clientele.

Unlike most general aviation airports, MMU has special aviation enhancements due to the high-end users of the airport, including:

- Air Traffic Control Tower ( which is staffed by the FAA and open between 6:45 a.m. to 10:30 p.m. seven days a week)
- Aircraft Rescue and Fire Fighting (24 Hour Index B Aircraft Rescue Coverage)
- U.S. Customs & Border Protection (User Fee Facility operated by Morristown Airport Customs Association)
- Noise Abatement Office

Other airport facilities and providers include:

Function	Provider
FBOs	Signature Flight Support FTC FBO, LLC
Flight Schools	American Flyers Best In Flight Certified Flyers II
Aircraft Maintenance	Syrek-Mee Aviation
Organizations and Clubs	150th Aero Club Morris Aero Club Skywagon Flight Club Civil Air Patrol
Fuel Farm	DM AIRPORTS LTD.

## H.7.2 Privatization Objectives and Motivations

In 1981, after operating the airport unprofitably for many years, the town had accumulated over \$2 million in debt for airport capital improvements even though its infrastructure was in a state of disarray. The airport's corporate users were threatening to leave because the airport and the FAA was threatening to close the facility if upgrades were not made. The town recognized it did not have the talent on staff to run the airport properly and looked to a private company to operate and manage it on their behalf, pay off the debt, and make the necessary capital improvements to appease

the FAA and tenants.

After careful consideration, the town concluded that the airport could be better operated and developed by a private entity. The town studied various proposals and considered several potential developers to run the airport.

Seeing the potential for commercial development on and around the airport, the DeMatteis Organization<sup>72</sup> formed D.M. Airport Developers, Inc. -- which later was renamed DM AIRPORTS LTD -- and entered into a 99-year lease with the town to operate, manage, and develop the airport. At the time, DM had plans to develop property for commercial, hotel, office, industrial and/or manufacturing purposes. However, subsequently, wetland limitations and the taking of 11 acres of airport property for expansion of Route 24 eliminated the expected potential for commercial land development.<sup>73</sup> Although DM had the option to terminate the long-term lease due to this land taking, it concluded that it could continue to successfully operate the airport without this developable property.

DM paid off the airport long term debt, made substantial upgrades to the airport with the aid of federal and state grants, and turned the airport into an economic catalyst for the town and the region.

### **H.7.3 Lease and Management Structure**

The Agreement of Lease between the town and DM was entered into in December 1981 with a term of 99 years commencing on May 1, 1982 and extending through April 30, 2081. Under the long-term lease, the town granted the full management and development control of the airport to DM in return for DM (1) paying annual rent to the town, (2) paying all outstanding airport debt service when due, and (3) undertaking all capital improvements. As such, DM has wide discretion and is responsible for making decisions regarding the development of MMU (i.e., capital improvement projects) and managing its operation, which includes among other things, negotiating leases, handling staff and services, and setting rates, fees, and charges. The only residual airport controls retained by the town are the signing of airport grants and approval of site plans, but the town is obligated to mutually cooperate with DM in securing such approvals. DM retains all revenues derived from its operation of the airport.

The base annual rent, which is paid in equal monthly installments to the town, is tiered as follows:

May 1, 1982 – April 30, 1983	\$30,000
May 1, 1983 – April 30, 1984	\$40,000
May 1, 1984 – April 30, 1985	\$50,000
May 1, 1985 – April 30, 1986	\$75,000
May 1, 1986 – April 30, 1993	\$100,000

The base annual rent is then adjusted every 5 years beginning in May 1993 based on the change in the CPI (for New York, N.Y.– Northeastern N.J.) using 1988 as the base year (and subject to specified caps). The annual rent is intended to cover the town's costs associated with the airport

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<sup>72</sup> The DeMatteis Organization is a family-owned organization with construction and real estate companies that has headquarters in Elmont, New York and Morristown, New Jersey. Its companies provide general contracting, construction management, design-build contracts, and interior construction and renovation.

<sup>73</sup> As a result of the land taking, DM's annual base rent was abated slightly. In addition, there was a negotiated settlement on the value of the land that was taken, which was shared approximately 80% by the town and 20% by DM.

under DM's operation, which consist of police services, auditing, and grant administration.

The lease also obligated DM to pay "Additional Rent" in amounts equal to the town's annual debt service payments on the outstanding debt incurred by the town for airport capital improvements prior to the commencement of the lease term.

The 99-year term of the lease was deemed necessary for DM to recover its payment of the town's outstanding airport debt and its investment in upgrading existing facilities and constructing new ones. DM also has responsibility for all airport repairs, maintenance, and operations (except police services which are provided by the town) and compliance with all governmental regulations. In addition, DM is responsible for obtaining at its own cost all site plan approvals and zoning approvals and permits for airport development airports with the full cooperation of the town.

The lease gives DM great flexibility in carrying out its charge of operating the airport as a public airport subject to all applicable laws, regulations and agreements, including compliance with FAA grant assurances. As stated in the lease:

*"Lessee shall assume the responsibility for and shall perform all repairs and maintenance of the Airport, and shall at all times keep the Airport in reasonably clean and orderly condition and appearance, take reasonably good care of the Airport, maintaining the same at all times in reasonably good operating condition, and as may be reasonably required by any governmental authority having jurisdiction... Lessee's sole responsibility hereunder shall be to maintain the Airport in reasonably good operating condition subject to deterioration caused by wear and tear."*

The lease also gives DM the right to mortgage all or any portion of its interest in the lease (without the town's consent) to obtain the most favorable financing needed for airport development. In addition, the lease is assignable "without restriction of any kind."

Airport users pay fees and charges directly to DM and DM assumes the risk involved in covering both operating and capital costs out of those revenues.

The lease served as a model for the Stewart lease under the Airport Privatization Pilot Program (APPP).

#### **H.7.4 Stakeholders**

**Labor.** When DM took over operation of the airport in 1981, there were approximately 35 employees on the airport payroll. The maintenance and operations staff was offered positions by DM, but most of the senior employees moved to positions within the town government to maintain their municipal status and pension benefits.

**Local Government.** The management contract has served the Town of Morristown well. The town's only responsibilities for the airport are police protection, emergency medical response, grant administration and audits, and site plan approvals. DM converted a facility in a state of disrepair into an economic engine by investing in the airport's infrastructure and providing a high level of service to the users. This arrangement has also worked well for Hanover Township, where the airport is located, because DM must pay land taxes to the township unlike a municipal operator.

**Community.** DM is responsible for all interactions with the community with regard to the airport. Morris County views MMU as a critical community asset for retaining and attracting business.

Therefore, the Morris County Freeholders<sup>74</sup> established an Airport Advisory Committee in 2003 to interact with DM and MMU tenants, which meets on a bi-monthly basis (but only if there is business to discuss). Although this committee has no jurisdiction over the airport or DM, it has been instrumental in bringing together residents, pilots, government officials, and airport personnel to address noise issues at MMU, among other issues. It also helps DM to build goodwill with the community.

Most recently, the Airport Advisory Committee has been concerned about aircraft delays experienced at MMU due to the congested airspace and interactions with Newark Liberty International Airport. In order to attract new business to the area, the Airport Advisory Committee wants to explore the viability of MMU as an asset and what can be done regarding the departure delays. The committee is interested in supporting the airport regarding initiatives in Washington that could be used to benefit operations and reduce MMU delays.

Although the airport is owned by the Town of Morristown, it is located in Hanover Township. DM pays land taxes and improvement taxes to Hanover Township. Typically, public airport owners and operators do not pay property taxes. Therefore, the township derives incremental tax revenues as a result of this business model.

According to the 2008 Economic Impact Study, MMU supports over 1,550 jobs and \$243.6 million in economic impact and, in aggregate, is the second highest tax payer in Hanover Township. The Airport generates over \$13.3 million in State and local taxes and provides incomes in excess of \$72 million to New Jersey residents.

DM actively engages the neighboring community through various channels on a voluntary basis. For example, since 2000, DM has provided annual scholarships to 16 local college-bound high school graduates each year in the amount of \$1,250 that may be used for tuition, books, or other eligible fees. In addition, DM sponsors every three years a full-scale emergency response exercise that is designed to simultaneously test the emergency operations plans for MMU, the town, and Morristown Municipal Hospital. It provides training for area firefighting and rescue personnel for mutual air response. DM also helps sponsor the free Hanover summer concert series.

DM also developed and administers a voluntary noise abatement program through the MMU rules and regulations. DM employs a dedicated Noise Abatement Officer who along with members of the Morristown Aviation Association monitors the program and encourages pilots to comply. Although the airport is located in a densely populated area, there are only a few people who complain regularly.

**Tenants.** DM also actively engages airport tenants through various channels. The Morristown Aviation Association (“MAA”) is an association of mostly airport tenants and some transients that was established to provide a forum for tenant interaction. DM jointly sponsors a periodic publication on airport updates with the MAA and the Morristown Airport Pilots Association.

As noted earlier, MMU also has U.S. Customs & Border Protection services for international flights. Because MMU does not have sufficient volume to justify a federal agent being assigned to the airport, the tenants decided to set up a user fee association to pay for one. DM administers the user

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<sup>74</sup> In New Jersey, county legislators are called “Freeholders.”

fee service on behalf of the Morristown Airport Customs Association. Tenants and transients pay to clear with higher rates for transients and nonmembers. Entities who clear frequently often become a member of the Association. The cost includes the fee for the federal agent, building rent, utilities, and a dedicated, secure internet line, none of which are a cost responsibility of DM.

The tenants also decided they wanted ARFF even though MMU is not a Part 139 airport<sup>75</sup> and ARFF is not required because of the high-end aircraft they use. Like customs, ARFF is not a cost responsibility of DM, but instead is funded by a surcharge on fuel flowage per gallon. However, DM puts out to bid and administers the ARFF contract. The FAA funded 95% of the cost of the ARFF station through an AIP grant as well as 95% of the cost of the first ARFF vehicle (up to Level A). The tenants paid for the cost of a second vehicle through the fuel flowage surcharge because the FAA said it would not support a Level B service.

In sum, DM maintains three separate sets of financial records – one for its own responsibilities and one for each of the user fee systems for the Morristown Airport Customs Association and ARFF.

A bi-monthly E-Newsletter called Morristown Airmail is published jointed by DM, MAA, and the Morristown Airport Pilots Association that summarizes airport news, projects, events, and issues as well as community aviation-related issues and outreach.

**FAA.** DM is the primary interface with the FAA and other federal agencies. The only role that the town plays is to execute grant agreements as the airport sponsor. DM is responsible for identifying Airport Improvement Program (AIP) grant projects, providing the Airport Capital Improvement Program (ACIP) input to the FAA for the 5-year capital plan, preparing and submitting the grant applications, project implementation, project management and controls, project accounting, and grant closeout.

DM also is responsible for all grant compliance unlike airports that are operated under management contracts where this responsibility remains vested with the public sponsor.

### **H.7.5 Consequences**

**Airport Management Team.** Initially the DeMatteis Organization contracted the management and operation of the airport to an airport management company (Avco) because DeMatteis did not have this expertise. Avco hired airport professionals to operate and manage the airport on behalf of DM. However in 1992, after having achieved stability within the airport management team and with Avco desiring to exit the airport management business, DeMatteis allowed the contract to expire and hired the airport management staff to work directly for DM. There has been little staff turnover at DM since that time. In November 2010, there were 28 professionals on DM's management team plus an independent contractor for security.

**Capital Improvements.** Airport capital improvements are funded with AIP grants, state grants, tenant financing (via long term leases), and/or DM capital contributions.

Most of the capital development performed by DM has been accomplished using federal and sometimes state airport grants. DM has been quite successful in securing federal and state grants,

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<sup>75</sup> Although not required, some large GA airports do have 139 certificates, which greatly affects staffing and operating expenses.

including a \$5 million American Recovery and Reinvestment Act of 2009 (ARRA) grant for taxiway rehabilitation, which is funded 100% by the FAA. For all other AIP funded improvements, the FAA participates at 95% of the eligible cost of the project and the state often provides half of the local match (2.5%).

When DM took over operation of the airport, the existing sole fuel farm on the airport was in a state of disrepair. DM contracted with Exxon in 1989 to finance, build, and maintain a new Jet A and Avgas fuel farm and become the fuel supplier. Because the airport is located in Hanover Township and because the township refused to permit more than one fuel farm (given the wetland constraints), DM operates the fuel farm servicing the airport's large tenant base and two fixed base operators (Signature Flight Support and FTC FBO).<sup>76</sup> When Exxon's 20-year lease expired at the end of 2009, the ownership and maintenance responsibility for the fuel farm reverted to DM. DM then entered into a 7-year fuel supply contract with Ascent Aviation Group, Inc., which is Phillips 66 Aviation's largest general aviation fuel marketer. DM wholesales fuel to the FBO's and corporate tenants who have a direct lease with them, which includes a fee to cover its liability, operation, and maintenance of the fuel farm.

DM constructed at its own cost the airport administration building and acted as developer for two hangar facilities for tenants. DM is planning a major repair of the fuel farm in the next few years.

**Operations.** DM employs 28 people on a full-time basis and hires seasonal workers in the summer and winter on a part time basis to assist with the administration and operations. DM performs a great deal of the airport operations and services with its own staff, but also contracts out several services, including:

- Aircraft Rescue Fire Fighting is contracted to Rural/Metro Corporation for 24/7/365 staffing
- Engineering consultants assist with AIP grant application preparation
- The security coordinator is an independent contractor<sup>77</sup>

The Morristown police department has the primary obligation to provide police services to MMU, which is done in consideration of the rent DM pays to the town.

**Revenue Base.** As a private company, DM does not disclose financial data, but was willing to share information on revenue sources. The vast majority of DM's revenues are derived from rentals, which are less subject to traffic volatility. For 2010, the share of revenues consisted of:

Tenant & Tie Down Rents:	66%
Fuel Sales (net)	25
Landing Fees	8
Miscellaneous Revenue	<u>1</u>
	100%

As noted earlier, given the competition for high-end GA services in the New York City

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<sup>76</sup> Although FAA grant assurances do not allow monopolies (e.g., a single fuel farm) on any airport developed with federal grant assistance, the assurances specifically allow one exception; if the airport sponsor provides the service itself.

<sup>77</sup> Several members of DM's operations staff have completed the Airport Security Coordinator course and have the designation in compliance with TSA regulations.

metropolitan area, DM is highly incentivized to provide strong customer service at reasonable prices for its clientele. For example, in 1991 one of the MMU three FBOs (Jet Aviation) decided not to renew its lease at the end of its term and instead consolidate its operations at Teterboro. DM spearheaded a redevelopment of the Jet Aviation site that had old, worn down facilities, which were torn down and replaced with a new, modern hangar. When another FBO site was being redeveloped, DM issued an RFP for a flight school and a new building was constructed so the flight schools were not displaced.

***Regional Economic Asset.*** Over the first 28 years of operations (1982 – 2010), DM has:

- Implemented capital improvements and provided the necessary facilities and services to meet aviation market demand
- Improved customer service at the airport by providing superior facilities and services at competitive rates
- Helped organized, manage, and participate in tenant customer service programs (e.g., the U.S. Customs & Border Protection and ARFF services)
- Marketed the airport’s desirable location and high-end facilities to retain and attract customers for the benefit of the local economy
- Transformed MMU into a financially self-sustaining, competitive facility for the region
- Elevated MMU’s position to be one of the two premier general aviation airport in northern New Jersey, with Teterboro as the other
- Fostered strong community relations by promoting the airport and engaging its tenants, the Morris County Freeholders, the local chamber of commerce, and other stakeholders
- Established a corporate identity for the airport through participation in aviation trade association events and conferences and marketing efforts, including its user friendly website
- Turned MMU into an economic engine for the town and the region

By contrast, as noted earlier, under the town’s operation, the FAA was threatening to shut the airport down due to its state of disrepair.

### **H.7.6 Lessons Learned**

It is important to note that the Morristown privatization occurred before the FAA promulgated its revenue use policy and before the creation of the APPP. Therefore, it is not reasonable to expect to be able to repeat this experience because the federal rules concerning, for example, the transfer of management responsibility and the use of rent proceeds and the private operator’s compensation, are much stricter now.

Nevertheless, the comprehensive long term lease of MMU was a first-of-its-kind experiment and as a result has provided some interesting and instructive lessons learned, including:

- Similar to the JFK IAT Terminal 4 project, the MMU long term lease did not require any special federal or state legislation (such as the Airport Privatization Pilot Program). In fact, it demonstrates that significant privatization can be accomplished within the existing regulatory framework.

- However, like the JFK IAT Terminal 4 project, there appears to be special circumstances that make the MMU experiment successful, in particular the demand for high-end general aviation users. Although DM has been approached by several other airports, DM has declined these offers because the market was not there for a viable business opportunity, suggesting that the business climate in Morristown is somewhat unique.
- The DeMatteis Organization learned that once a professional staff was in place and successfully operating the airport it was no longer necessary to contract out the airport management and therefore was able to save money by no longer having to pay the annual management fee.
- According to DM, privatization allows for a more efficient and effective way to operate the airport. Decisions can be made in a timely manner. Moreover, bureaucracy, politics, and competing funding priorities do not factor into the business decisions. Unlike the Indianapolis management contract, DM is not required to adhere to local municipal procurement regulations, which allows for greater operating efficiencies and speedier delivery of services.
- Due to the nature of the agreement (in particular its term and development responsibilities), DM pays land and improvement taxes to Hanover Township. Typically, public airport owners/operators do not pay property taxes. Therefore, this type of privatization allows a local municipality (other than the owner) to derive incremental tax revenues.
- Community outreach is important for airports. Although not mandated in the lease, DM actively and successfully engages the community and its tenants. This is an area for possible improvement in a lease in the event the lessee was not as committed to the airport and its rapport with the community.
- The lease does not include specific oversight and performance standards. This would typically be included in a long-term lease or management contract of this type. However, given the competitive nature of high-end general aviation use in the New York metropolitan area, DM is incentivized to provide a high level product.
- The term of a long-term agreement, where the public sponsor grants full management and development control to the operator under in return for the operator undertaking full capital improvements, needs to be considered carefully. Where significant airport development is anticipated, the term of the lease should be related to the length of time needed by the operator to recover its investment. In this case it was felt that a 99-year lease was needed due to DM's obligation to defease the \$2 million in outstanding airport debt and make the necessary improvements to the airport. Whether a 99 year lease is necessary or appropriate for a similar deal should be carefully considered. DM pays a relatively modest annual rent for the privilege of retaining all airport fees and charges in return for taking on the risk to cover operating expenses and capital expenditures (net of grants) out of those revenues.
- The form of compensation – upfront lump sum vs. annual rent – is also something to be carefully considered and evaluated. The town decided to take the annual rent to cover its cost to provide continuing police, emergency medical, and grant administration services for the airport. By comparison, the city of Chicago opted for an upfront payment and set aside funds for its ongoing obligation to provide police and fire protection for Midway Airport.



- The lease does not have definable requirements for maintaining the airport other than “maintain the Airport in reasonably good operating condition subject to deterioration caused by wear and tear” and there is no obligation to set aside funds towards the end of its term to make sure the asset is in good condition when the lease expires. For example, under the proposed 99-year Midway lease the operator was required to prepare a capital asset maintenance plan, capital improvement program report, and five-year capital improvement program each year and submit them to the city and the airlines for approval. While DM has done a good job maintaining the airport after 28 years of stewardship, there could be stronger requirements in the lease about maintaining the airport in the later years of the term.

### **H.7.6 References**

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## H.8 Sydney Airport

Sydney Airport is Australia’s busiest airport (with 33m passengers in 2009) the only major airport serving Sydney – the country’s leading commercial and business center, and a major international gateway as well as being 28<sup>th</sup> airport busiest in the world. Sydney is served by 40 international airlines and 9 domestic and regional airlines.

The airport is located 8km south of Sydney’s central business district with a catchment area of 6 million people, on a constricted 907 hectares site. Sydney has two parallel runways extending north-south into Botany Bay on reclaimed land and another runway east-west. The three terminals (two domestic and one international) combined have the capacity of about 65 million passengers per annum.

Sydney Airport is the operation base for Qantas serving all major international and domestic destinations including Jetstar, Qantas’s low-cost carrier. Other major carriers are Virgin Blue, Air New Zealand, British Airways, United Airlines, Singapore Airlines and other major Asian and Middle Eastern Airlines.

**Table H.18. Key Financial Information, 2009-10 <sup>78</sup>**

Aeronautical revenue (\$'000)	\$83 841
Non-aeronautical revenue (\$'000)	58 249
Increment in fair value of investment property (\$'000)	7 182
<b>TOTAL REVENUE (\$'000)</b>	<b>149 272</b>
Total expenditure (\$'000)	70 875
Operating profit (\$'000)	79 297
Profit after tax (\$'000)	9 402

### H.8.1 Transaction Background

Until 1987 over 80 airports in Australia were owned and operated by the Commonwealth Government. The Government tried to devolve ownership to local authorities for some airports through measures such as the Aerodrome Local Ownership Plan. This was successful for Cairns Airport in 1980. However through this policy there was still a large degree of Government subsidies needed and the financial burden increased. As a result, in June 1986, the Australian Government (“Government”) established the Federal Airports Corporation (“FAC”) as a Government Business Enterprise<sup>79</sup> for the ownership and operation of the 23 Australian airports serving the major capital city airports, the secondary airports in those cities, and the major regional airports, including Sydney Kingsford Smith Airport (“Sydney Airport”).

By the early 1990s, the Government’s economic policy moved towards privatization or private participation in all Government Business Enterprises. The Airport Privatization Program began in April 1994 when the Government announced its intention to privatize 22 FAC owned airports (Cambridge Airport was sold in 1993). A year later a decision was made to lease each airport by way of individual trade sales to private entities in two phases. In 1996, two acts were passed by Parliament to facilitate the privatization of these airports – the Airports Act 1996 and the Airports

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<sup>78</sup> Airport monitoring report- Price, financial performance and quality of service monitoring, 2009-10, Australian Competition & Consumer Commission

<sup>79</sup> Government Business Enterprise is a wholly Government-owned unlisted public company.

Transitional Act 1996. The Airports Transitional Act was of particular importance, as it facilitated the lease of these airports to private sector operators.

The privatization of airports in Australia was divided into 3 phases:

- Phase 1 -- Melbourne, Brisbane and Perth airports (July 1997)
- Phase 2 -- comprised 8 major airports (Adelaide, Alice Springs, Canberra, Coolangatta, Darwin, Hobart, Launceston, and Townsville) and 7 regional airports (June 1998)
- Phase 3 – Sydney Airport (June 2002) and 3 smaller airports in the Sydney region (December 2003)<sup>80</sup>

In March 2001, the Government announced its intention to dispose of its 100% interest in Sydney Airport by means of the trade sale of a concession with a total length of 99 years.. The process was uninterrupted, however, as a result of the disruptions to the aviation sector and to financial markets caused by the events of September 11, and the collapse of Ansett Airlines, the second largest domestic Australian operator (after Qantas) with some 40% of the traffic. The process was resumed in March 2002, and the sale to the Southern Cross Airports Corporation was announced in June 2002..

The Southern Cross Airports Corporation was led by Macquarie Airports (40% interest). Other consortium members included the Macquarie Airports Group (12% interest), Ferrovial (20% interest) and Hochtief (15% interest).

An important condition of the sale of Sydney Airport was that the Southern Cross consortium was given the first right of refusal, with a duration of 30 years, to build and operate any second major airport within 100 kilometers of the Sydney Airport.

## H.8.2 Objectives

As part of the privatization of Sydney Airport, the Australian Government formally announced the objectives of the sale, which were as follows:

- Optimize sale proceeds within the context of the broader Government sales and policy objectives.
- Minimize the Commonwealth's exposure to residual risks and liabilities.
- Ensure that the airport lessees have the necessary financial and managerial capabilities to operate and provide timely investment in environmentally appropriate aviation infrastructure at Sydney (Kingsford Smith) Airport.
- Ensure the sale outcome is consistent with relevant airport legislative, regulatory and policy requirements, including environmental, foreign investment, competition, access and pricing policies.
- Ensure fair and equitable treatment of employees of Sydney Airports Corporation Limited,<sup>81</sup> including the preservation of accrued entitlements.

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<sup>80</sup> The sale of the Sydney airports was deferred to resolve noise issues and complete an environment impact study for a proposed second Sydney Airport.

- Ensure the airport lessees demonstrate a commitment to the effective development of airport services, consistent with Australia's international obligations.

A number of stakeholders were interviewed to obtain their views on the Government's objectives in relation to the sale. Generally, their views reinforce the objectives listed above. Optimizing sale proceeds, minimizing ongoing liabilities, and securing future investment in the airport were mentioned as objectives by most stakeholders we interviewed. However, it is clear that a number of other factors played a role. Several stakeholders mentioned efficient operation of the airport as a key objective:

*"If anything the strongest driver was a belief that the airport would be more efficient and commercial outside the public ownership." (Former member of airport management privatization team)*

Stakeholders also pointed to some of the Government's requirements for potential buyers as indicative of the Government's concerns and objectives. For example, the Government imposed a foreign ownership limit of 49%, meaning that a majority interest of Sydney Airport had to remain Australian-owned. Stakeholders speculate as to the Government's objectives in this regard:

*"The Government was keen to ensure that the majority of the ownership of strategic assets remained in Australian hands so that at least part of the benefits from privatization and resulting improvements in efficiency were kept within Australia." (Investor in Sydney Airport)*

Many stakeholders felt that, although the foreign ownership limit helped the Australian Government achieve certain objectives, this restriction had had a negative impact on the transaction proceeds raised by the Government.

*"Although imposing this restriction probably had a negative impact on the transaction proceeds, it enabled the Government to meet one of its key objectives." (Investor in Sydney Airport)*

It is interesting to note in this regard the point made by a representative of the largest investor in Sydney Airport, MAp Airports.

*"The foreign ownership restriction, combined with the financial climate at the time [the sale took place several months after September 11, 2001] restricted the amount of equity that was available to fund the acquisition." (MAp Airports representative)*

MAp Airports' strategy of creating a listed entity to fund the acquisition allowed it, effectively, to sweep up most of the available equity, in a limited Australian market, meaning that other bidders found it difficult to locate enough equity to compete.

Another restriction imposed by the Australian Government was a cross-ownership restriction of 15%, which meant that, for example, the owner of Melbourne Airport would not be allowed to own more than 15% of Sydney Airport. An airline ownership limit was also introduced.

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<sup>81</sup> Sydney Airports Corporation Limited (SACL) was formed in July 1998 as a Government Business Enterprise.

*“Maintaining a degree of competition had been a concern and there had, for example been a number of safeguards on the cross-ownership of airports and a limit on airline ownership of 5%.” (ACCC, Australian regulator)*

The main objective of these restrictions was to secure effective competition between Australian airports where possible. However, in contrast to this restriction, the Australian Government did offer the successful bidder for Sydney Airport a 30-year right of first refusal over the development and operation of the second Sydney once it was decided this was needed, as long as the second airport is within a 100km of the current airport. This removed an uncertainty overhanging the deal as well as provided a potential pragmatic solution to the problem of developing a second airport in the face of a determined competitive response from an entrenched and well-sited main airport.

### H.8.3 Transaction Process

The decision to sell Sydney Airport on March 2001 via a three stage tender process designed to maximize financial returns with a view for financial close by late 2001, however, the process was put on hold after the events of September 2001 and the collapse of Ansett. Throughout the period the process was put on hold contact was maintained with the three shortlisted bidders. In March 2002 the tender process recommenced at the binding bid stage and all three shortlisted bidders were invited to submit bids.

**Table H.19. Sydney Airport Privatization Timeline**

December 2000	Australian Government announces its intention to privatize the Sydney basin airports with Sydney Airport being sold separately from Bankstown, Camden and Hoxton Park
29, March 2001	Australian Government announces its intention to dispose of its 100% interest in Sydney Airport by means of a trade sale process
23 April 2001	Invitations for Expressions of Interest was advertized
14 May 2001	Expression of Interest deadline. 13 responses were received. Two were declared bidding consortia, four were in the process of forming another bidding consortium and a further seven parties. The Minister advised parties that three or four competitive consortia were sort for the indicative bid stage. All 13 parties were admitted to the next stage but three chose not to participate further.
4 June 2001	Indicative bids are requested
17 July 2001	Deadline for indicative bids. Three bids were received.
1 August 2001	All three indicative bids are accepted and requested to submit binding bids due on 17 September 2001.
13, September 2001	The terrorist attacks of 11 September shake the aviation industry and the deadline for binding bids is postponed to 26 September 2001
24 September 2001	The sale is deferred to early 2002 because of the disruption to the aviation and airline industry by the events of 11 September and the collapse of Ansett.
March 2002	Tender process is resumed at binding bid stage. All three bidders are notified that they will be requested to submit bids
26 April 2002	The Request for Binding Bids is reissued
12 June 2002	Deadline for binding bids, three binding bids were received.
25 June 2002	Southern Cross Airports Cooperation was announced as the preferred bidder
28 June 2002	Financial close, Sydney Airport is sold to the Southern Cross Airports Corporation for A\$5.6 billion (approx US\$3.2bn)

The process of privatizing all of Australia's airports appears to have been seen as a relatively smooth one, and investors in Sydney Airport in particular were complimentary about the well-run process and its clear timetable. This was despite the fact that the sellers had to overcome the difficulties of coping with the September 11 crisis and the loss of Ansett.

The success of the privatization program is attributed by one stakeholder to the extensive scoping studies conducted in the years preceding privatization:

*"The privatization process for Australian airports has generally gone smoothly and successfully. This was partly because a lot of work had been done in comprehensive scoping studies in advance of the sales. This meant that issues such as IPO or trade sale, foreign ownership, leasehold or free hold, and selling the Australian airport system as a single entity or broken up had been thoroughly dealt, and most of the associated uncertainties resolved, well before the process started."* (**Former member of airport management privatization team**)

The issues mentioned in the quote above do indeed appear to have been considered carefully by the Australian Government prior to privatization. The stakeholders interviewed were generally supportive of the decision to pursue a trade sale strategy rather than an IPO. The following points were made:

*"The Sydney Airport privatization is a good example of some of the advantages of privatization via trade sale rather than IPO. In a trade sale, transaction proceeds are typically higher, and the privatized airport is often run more efficiently as a result of having an interested, educated investor who provides constructive challenge to the management team. Also, by running a trade sale process, the Government creates the opportunity for itself to negotiate a contract with the buyer, to ensure some of its wide transaction objectives are safeguarded. An IPO does not have these advantages, and in addition carries the risk of an embarrassing loss of value for the Government, as following an IPO shares are often acquired as part of a takeover offer at a much higher price."* (**Investor in Sydney Airport**)

In addition to the reasons listed above, one stakeholder pointed out that the decision to sell Australia's airports individually rather than as a group made a trade sale a more attractive option. An IPO would have been difficult to realize for all but the largest of Australia's airports.

It appears that the Government's decision to privatize the airports individually was driven by two main reasons. First, as already noted, there was a desire to promote a degree of competition among Australian airports where possible. Second, it is speculated that management of the FAC at the time was not considered to be particularly strong, and selling the airports individually via trade sales was deemed to be a good opportunity to attract strong technical expertise.

Another issue that was examined in advance of the privatization of Sydney and other Australian airports was the freehold versus leasehold debate. Stakeholders suggested that a leasehold was selected principally because the Government did not want to relinquish control of its assets entirely, especially in symbolic terms, where perceived loss of power over a major asset of national importance can be exploited by political opponents. However, despite the formal retention of ownership by the Government, bidders were able to use the land of the airport as security when borrowing, which helped improve the financial attractiveness of the airport.

The lease has a term of 49 years with an option to extend by another 50 years, making it effectively 99 years long. One of the stakeholders pointed out the importance of the length of the lease:

*“We have experience with leases of different length, and would suggest that anything under 40 years is problematic as it means that property development at the airport is generally not viable, unless the Government becomes involved in agreements to cover the period after the concession ends.” (Investor in Sydney Airport)*

The collapse of Ansett (which, as noted earlier, together with the events of September 11 caused a 6 month delay to the sale) had an unexpected benefit - it provided the opportunity for airport management to purchase the old Ansett terminal and transform it into an open access facility for other airlines.

One of the stakeholders interviewed commented that the decision to pursue a trade sale strategy rather than an IPO helped overcome the difficulties associated with these disruptive events:

*“The fact that the process took place at all was partly because it was a trade sale rather than an IPO: some parties had been prepared to bid even if the postponement had not taken place (though the price would have been significantly lower).” (Former member of airport management privatization team)*

#### **H.8.4 Economic Regulation**

Almost all stakeholders, when asked to describe the transaction process, place great emphasis on the economic regulation of charges at Sydney Airport for the privatization. Very significant changes were made in the lead-up to the privatization, as outlined below.

In the period from 1996 to 2002, all major Australian airports with the exception of Sydney Airport (which was Government-owned at the time and subject to significant re-development in advance of the 2000 Olympics) had been subject to price cap regulation.

In 2001, the charges at Sydney were subject to a separate review by the Australian Competition and Consumer Commission (“ACCC”), which led to a full dual till cost-based system being introduced. The combination of the cost-based approach with the major investments at Sydney to prepare the airport for the Olympics, and an asset revaluation, led to an increase in charges of close to 100%. It was intended that prices would remain at this level for 5 years. In 2002, however, following a review by the Productivity Commission (“PC”), the Government announced that it would remove price caps for the airports for a 5-year period, and instead introduced a **light-handed approach** under which prices and service levels would be negotiated between airport and airlines with the results being monitored by the ACCC, and with a review of the arrangements to be conducted by the PC at the end of this period. This approach was applied to Sydney Airport, which was privatized in that year alongside the other major airports which had been privatized previously. This form of regulation was seen as promoting a commercial relationship between airport and individual airline customers with an opportunity to negotiate agreements covering service, capital expenditure and operational issues as well as simply price.

Under this system the airports have in practice adopted a form of shadow regulation, in which prices agreed with airlines are based on a dual till costs approach in a similar manner to that previously applied by the ACCC to Sydney. An issue which led to continuing debate during the initial period was the revaluation of assets, which airlines believed had led to unjustified opportunities for price hikes.

In 2007, after a second review of the operation of the privatized airports, the Government announced its intention to continue the monitoring approach of charges at Sydney and other major Australian airports for a further 6 years when another PC review would take place. It also resolved the revaluation issue by setting a retrospective 'line in the sand' after which no further revaluations would be accepted for monitoring purposes.

In 2010, as a results of the price and service monitoring undertaken by ACCC, the Government announced that there were concerns over the service provided at Sydney Airport and that it intended to bring forward this review for Sydney to 2011.

The regulatory framework was discussed with a number of the airport's stakeholders. The regulatory process was described by a regulator from the ACCC:

*"Under the Australian airport regulatory system, there are no direct price controls on aeronautical charges (other than for regional services). Instead the airport is left to negotiate charges with airlines as part of commercial agreements. The regulator plays no part in these negotiations and (unlike the position under some other jurisdictions) does not play a role in resolving negotiation log jams, under normal circumstances. This is intended to promote the two parties reaching commercial agreement rather than resorting too readily to third parties to sort out their problems."* (ACCC, **Australian regulator**)

This approach is regarded as sensible by airport investors:

*"The regulation that was chosen was based on the underlying belief that economic partners (airports and airlines) should be given the freedom to negotiate their own commercial agreements. In this way, the Government wanted to ensure that any capital expenditure met the needs of airline users. The regulator, the ACCC, would only become involved if agreement could not be reached. Generally, this approach to economic regulation has been very successful."* (**Investor in Sydney Airport**)

One of the airline representatives interviewed was somewhat more guarded in his views, explaining that it took a number of years for the relationships between airlines and the airport to mature, as each party gradually developed a greater degree of understanding (and to some extent acceptance) of the other party's business model. Another airline representative believed the relationship remained problematic:

*"Although a good working relationship now exists between Sydney Airport and its airlines, there are still frequent discussions and arguments."* (**Airline representative body director**)

In order to protect against a potential abuse of market power, the ACCC monitors both prices and service quality on an annual basis. Service quality monitoring is an important tool in measuring potential abuse of market power because under-investment or inappropriate cost cuts are as powerful as increased charges in terms of enhancing the profitability of an organization with market power.

The ACCC provided an interesting example of the system in operation:

*"A recent ACCC monitoring report had indicated significant areas of concern over service at Sydney in particular (albeit hedged with careful qualification based on the limitations of the evidence available). This had led the*



*Australian (Commonwealth) Government to bring forward the next Productivity Commission review.” (ACCC, Australian regulator)*

Although generally, the regulatory regime put in place as part of the privatization appears to be working reasonably well, one stakeholder pointed out that legacy airlines in particular may not have been ready for the opportunities provided by direct negotiation with the airport.

*“Large legacy airlines in particular could have a significant degree of inertia and lack of clarity on decision-making responsibility.” (Former member of airport management privatization team)*

Investors indicate that the regulatory regime helped the Government maximize sale proceeds. This is consistent with the perception in some quarters that the regulatory regime is more favorable to the owners of the airport than some others.

*“The privatization could have been much more beneficial to airlines if the regulatory regime had been better designed. The current regulatory regime in Australia is very favorable for airport operators.” (Airline representative body director)*

The service level concerns outlined by the ACCC illustrate a possible downside to airlines of an investor-friendly approach. Regarding this issue, investors in the airport outlined what they believed was principally a public relations rather than a genuine concern:

*“It is true that following the privatization, there has on occasion been negative press about profit levels and service standards at the airport. This is probably not linked to the privatization itself, but is the result of the fact that one of the airport’s large shareholders, Macquarie, an investment bank with a high local profile, is sometimes portrayed in a negative light by some of the media.” (Investor in Sydney Airport)*

A former member of the airport management privatization team agreed:

*“Despite the tendency for negative press, the service actually provided to passengers had held up, both as a result of agreements with airlines and in order to sustain retail revenues (which are a major component of income). Although they might not say so publicly, relationships with airlines as customers were substantially improved.” (Former member of airport management privatization team)*

A senior member of the airport’s current management team made the following statements regarding service level concerns:

*“The airport cannot ‘sweat the asset’, as it must submit a 20-year capital plan to the Government that is refreshed and approved every 5 years by the Government.*

*The airport participates in the ACI passenger survey program and conducts its own monthly surveys of passengers. It will not accept standards below 75%.” (Current senior management team member)*

However, airlines are concerned that the regulatory regime does not provide sufficient incentive for investment in aeronautical infrastructure:

*“[The dual till approach] creates an incentive for the airport to invest in non-aeronautical infrastructure. This is currently causing a number of problems at Australian airports, including Sydney. While significant amounts of money*

*are being spent on improving retail facilities, there is a shortage of aeronautical infrastructure such as aircraft parking facilities.” (Airline representative body director)*

A final point of interest in relation to economic regulation in Australia is that the regime currently applicable to Sydney Airport as well as other large Australian airports was put in place after those other airports had already been privatized. One of the stakeholders suggested that Government proceeds for the other airports would have been higher had they made the regulatory changes in advance of those privatizations.

### **H.8.5 Consequences**

Stakeholders were generally positive about the consequences of the privatization, and listed a number of benefits. Key benefits mentioned by almost all stakeholders are increased efficiency and better commercial relationships with airlines, particularly in the area of investment.

*“Costs are significantly lower; investment is better handled, more cost effective and better targeted, pricing is more flexible, there are better commercial relationships with airlines and management is much more responsive.” (Former member of airport management privatization team)*

*“There have been a number of positive consequences as a result of the privatization, particularly in the area of investment. The concept of negotiating each item of ‘necessary new investment’ as it arose has helped to align the interests of airlines and the airport.” (MAp Airports representative)*

*“Perhaps most importantly, privatization has ensured efficient use of the airport infrastructure. Estimated capacity of the airport has doubled since the airport was privatized, while significant capital expenditure has been avoided. (Investor in Sydney Airport)*

Some less obvious benefits were also raised by stakeholders. Two stakeholders mentioned the fact that, as the Government no longer owns the airport, it may now be perceived as approaching panning and regulatory issues in a more independent manner.

*“The Australian Government now faces fewer conflicts of interests as it no longer owns the airport. Although it is possible for Government entities with no involvement in airport ownership, to deal independently with, for example, regulation and environmental matters on an arms length basis, in the eyes of the public this is often confusing.” (MAp Airports representative)*

In addition, it was felt that the privatization of Sydney Airport has had a positive impact on the airport itself and the risks to which it is exposed as a business:

*“Privatization has helped Sydney Airport in enabling it to broaden the traffic base and lessen its dependence on Qantas.” (MAp Airports representative)*

This statement was supported to some extent by the former Qantas representative:

*“Since the privatization, Qantas has seen limited growth in its operations at Sydney Airport, and the majority of growth has come from other carriers. This is not, however, a direct result of the privatization, but rather a deliberate strategy on the part of Qantas to focus its operations on those routes which are most profitable.” (Former Qantas representative)*

However, not all stakeholders were exclusively positive about the privatization. The ACCC was more guarded about the benefits of privatization:

*“Broadly, the reforms under National Competition Policy had worked well, especially where had been competition effective. The performance elsewhere has been less clear and Sydney in particular has recently given cause for concern on service and on its relationships with airlines.” (ACCC, Australian regulator)*

A former member of the airport management privatization team also presented a mixed view, listed in a number of negative consequences of the privatization:

*“The negatives include:*

- *A community and industry concern that the airport is using monopoly power. This was partly at least a PR issue;*
- *Partly in response to this, creeping intervention by the Government which had extended price monitoring to car parking and other areas and had started effectively providing guidelines for pricing discussions (leading effectively to ‘shadow regulation’ rather than fully commercial pricing); and*
- *Poor management of planning issues by central Government – (particularly in areas such as airport retail developments and hotels) which may partly reflect the lack of a Government ‘interest’ in the airport and its prosperity. Effectively the planning limits were less sympathetic to airport commercial initiatives after privatization than before.*

*Despite the negatives privatization has undoubtedly been a good thing – largely because the airport is so much better run and able to respond flexibly to new opportunities and/or problems.” (Former member of airport management privatization team)*

## **H.8.6 Lessons Learned**

On balance, it appears that the process of privatizing Sydney Airport was a smooth one, and that it has been regarded as a positive development for the airport and the majority of its stakeholders. Stakeholders provided comments on lessons learned as part of the process, and whether there was anything they would have done differently in hindsight.

- A point raised by a number of stakeholders is the importance of establishing a long-term regulatory regime in advance of the privatization. The clarity that was provided to potential buyers as part of the Sydney Airport privatization is believed to have had a positive impact both on the transaction process and on the proceeds raised by the Government. Airline representatives agreed that a clear regulatory regime was important:

*“A clear regulatory framework is not only more attractive to the parties involved in the privatization, but is also helpful for airlines as it reduces uncertainty and enables them to plan their business in spite of the ongoing privatization.” (Former Qantas representative)*

- Many stakeholders also felt that the nature of the regulatory regime put in place for Sydney Airport had had a positive impact. One stakeholder stated the following:

*“A second lesson has been that leaving airlines and the airport to settle prices between them has worked successfully in the absence of an imposed regulatory arbiter to deal with log jams. My view is that the presence*

*of an arbitration option would make it significantly harder to reach a commercial resolution.” (Former member of airport management privatization team)*

The regulator itself, the ACCC, is not as positive about the regulatory regime:

*“The evidence available suggests that at some airports, price negotiations have gone relatively smoothly and that the airport and airlines have entered into positive commercial relationships. This can not be said for Sydney.*

*“ACCC staff’s view is that the progress of negotiations under price monitoring would have been more effective if a clearer framework on key issues had been established at the outset of regulation. This might have covered issues such as: charging approach, cost of capital, cost allocation and the valuation of assets (which had had to be dealt with by the Productivity Commission in their second review).” (ACCC, Australian regulator)*

An airline representative made the following comment:

*“Although airlines are probably better off now than they would be had the airport remained publicly owned, significant improvements remain possible, particularly with regard to the level of charges at Sydney Airport and the investment in aeronautical infrastructure.” (Airline representative body director)*

- Another lesson learned mentioned by several stakeholders is the need for careful management of public relations at the time of a privatization and afterwards. A number of stakeholders’ felt that some of the negative press received by Sydney Airport in relation to, for example, service standards, is not necessarily justified but is instead the result of poor public relations management.

*“Privatization has meant that the airport no longer has the ‘benefit of the doubt’, particularly since its majority owners were funds managed by Macquarie – perceived as an aggressive, short-term profit focused, investment bank. The airport would have gained substantially from a more sensitive approach to decisions and their presentation in the wake of privatization which might have avoided the generally negative press coverage that the airport now receives.” (Former member of airport management privatization team)*

- Finally, thinking specifically about the US debate on privatization, one stakeholder stated that the role of airlines in airport privatization needs to be carefully considered.

*“As airport customers, their views and concerns need to be taken into account, for example through appropriate regulation. However, they should not be given undue control within the privatization process itself and after the takeover by the private owners.” (Investor in Sydney Airport)*

## H.8.7 References

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## H.9 London Gatwick Airport

Gatwick is the second busiest airport in the UK in terms of passengers and also is the leading airport for point-point flights in Europe. Gatwick has only one runway, which operates near full capacity, and two terminals. Gatwick is serviced by several major airlines such as British Airways, Delta, US Airways and Virgin Atlantic and is also popular with charter and low cost airlines such as EasyJet, Flybe, Monarch and Thomas Cook Airlines. In the UK it is unique to have a range of business models (full service 51%, low cost 25% and charter 24%) serving the same airport and terminals. In 2009, Gatwick served 32 million passengers making it the 9<sup>th</sup> busiest airport in Europe in terms of passengers.

Trans-Atlantic routes are very prominent at Gatwick this stems from the Bermuda II agreement that was in place until 2008 which limited the use of Heathrow for Trans-Atlantic flights.

**Table H.20. Key Financial Information, 2008 (restated in U.S. dollars)<sup>82</sup>**

Aeronautical income	\$97.3
Concessions income	83.9
Property income	14.3
Specified charges, utilities and other income	26.7
<b>TOTAL INCOME</b>	<b>222.3</b>
Operating costs	142.0
EBITDA before exceptionals	80.3
Reported EBITDA (including exceptionals)	70.9

### H.9.1 Transaction Background

The Airports Act of 1986 made the UK the first country to privatize its airports by forming the British Airport Authority (BAA) by means of an initial public offering (“IPO”). BAA owned Heathrow, Gatwick (until 2009), Stansted, Glasgow, Edinburgh, Aberdeen, and Prestwick airports in the UK. In 2006, BAA was acquired by Ferrovial.

Following the acquisition, in March 2007, the UK Competition Commission (“CC”) commenced a market investigation to determine whether the supply of airport services by BAA restricted or distorted competition in the UK. The investigation came in response to concerns raised by the Office of Fair Trading over BAA’s perceived monopoly of airport services in the UK and in particular in the South East of England and Lowland Scotland. In 2008, BAA handled 62% of passengers traveling in the UK and faced criticism that its effective monopoly resulted in lack of investment and compromised service levels.

In an interim ruling by the CC in August 2008, BAA was told it may have to sell 3 of its 7 UK airports, including 2 in the South East. As a result, Ferrovial chose to pre-empt the CC’s final ruling and announced its intention to sell Gatwick on September 17, 2008. It was speculated that Ferrovial opted to bring forward the sales process in order to raise funds to help repay £1 billion in debt facilities held by BAA, due for repayment in March 2010.

<sup>82</sup> Vendor Due Diligence report, January 2009. British pounds were converted to U.S. dollars based on the average conversion rate for calendar year 2008 using monthly conversion rates from x-rate.com.

The CC published its final report in March 2009. It required, among other things, the divestiture by BAA of two London airports, Gatwick and Stansted. Since then, the CC's ruling has been subject to two appeals. First, BAA appealed successfully to the Competition Appeal Tribunal on the grounds of apparent bias. However, in October 2010, this ruling was overturned and the requirement to sell Gatwick and Stansted reinstated. BAA has indicated its intention to appeal the latest ruling in the Supreme Court. In the meantime, however, Gatwick Airport has already been sold to Global Infrastructure Partnership, as discussed below.

It should be noted that following the completion of the sale process, the Competition Tribunal upheld BAA's complaint that the CC's recommendations on the break up of BAA were invalid as a result of the inclusion on the Panel of an advisor who had links with one of the potential bidders.

The Gatwick Airport transaction occurred in a period of great economic uncertainty. The airport's traffic figures had been steadily declining since the beginning of the 2008 summer season, with several airlines ceasing operations entirely. This was the result of challenging global market conditions due to high oil prices and global recession and the shift of transatlantic traffic to Heathrow airport following the Open Skies agreement. Bidders had to make difficult assumptions on how quickly they expected traffic levels to recover. The table below identifies the effects certain changes had on passenger levels between 2008 and 2009.

**Table H.21. Effects on Number of Passengers<sup>83</sup>**

	Passengers (millions)
<b>2008</b>	<b>35.6</b>
Open Skies	-1.6
Charter airlines	-0.9
Other (Oasis, Zoom administrations etc)	-1.1
Growth of Low Cost Carriers (easyJet, Flybe, Aer Lingus etc.)	1.2
<b>2009</b>	<b>33.2</b>

Source: LeighFisher.

One of the key issues during the transaction was what assumptions to make on the construction of a new runway within the London airport system, with airfield capacity currently acting as one of the primary constraints on future growth. Furthermore, it was suggested that Gatwick Airport could be removed from price controls (de-designated) following its separation from BAA – a process which would be enhanced by the scope for competition following the construction of further runway capacity in the South East system (initially at Heathrow and Stansted). In practice, however, the new British Government elected to in May 2010 announced that it will not allow the building of a new runway in the London system leaving questions over how capacity issues will be addressed, and the opportunities for competition unanswered.

## H.9.2 Objectives

There were a number of different organizations involved in the sale of Gatwick Airport, with different sets of objectives. Stakeholders generally believed that the objectives of the seller, Ferrovial, were closely linked to the CC's investigation.

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<sup>83</sup> Jacobs Consultancy London Gatwick Airport Sale Report, April 2009.

*“The ongoing Competition Commission investigation meant that there was a risk of a forced sale of Gatwick Airport in the near future. A voluntary disposal had the advantage of avoiding a fire-sale under adverse conditions.”*  
**(Gatwick Airport acquirer representative)**

*“The objectives of Ferrovial as part of this process were both political and financial. Selling Gatwick addressed some of the competition concerns which culminated in the Competition Commission investigation.”* **(Former member of BAA management and adviser to Gatwick Airport bidder)**

As suggested by the quote above, it is likely that the seller in this transaction was driven by financial objectives as well as a desire to pre-empt the outcome of the CC’s investigation. Several stakeholders mentioned the fact that some of the debt which Ferrovial used to fund the takeover of BAA needed to be refinanced, and that the proceeds from the sale of Gatwick would help improve Ferrovial’s financial positions in what were difficult financial times.

It was felt, however, that in the absence of the CC’s investigation, Ferrovial might not have chosen to sell Gatwick in 2009.

*“The timing of the sale was particularly unfortunate as it was launched pre-financial crisis but suffered the credit crunch in the middle of the process which led to a number of bidders dropping out of the sale process due to limited credit availability. If the sale had been purely driven by financial concerns Ferrovial might have chosen to delay the sale of Gatwick to a time when economic conditions were less adverse.”* **(Former member of BAA management and adviser to Gatwick Airport bidder)**

*“However, even though the sale was not forced, it is unlikely that Ferrovial would have chosen this time to sell in the absence of the Competition Commission investigation. The financial downturn had implications for passenger numbers at the airport, and there was uncertainty about the location of new runways in the South-East of England.”*  
**(Gatwick Airport acquirer representative)**

The fact that the sale took place at a less than optimal time was reflected in the fact that all three final bids for the airport were reported to be at significant discounts to the Regulatory Asset Base (“RAB”). The RAB effectively represents the amount which future income streams are designed to remunerate and would normally be regarded as a minimum value (value less than the RAB would indicate causes for belief that past investment will not be fully paid for). On October 21, 2009, Global Infrastructure Partnership was announced as the successful party with a winning bid of £1.51bn, roughly equating to a 6% discount to the RAB. In its 2009 annual results, BAA reported a £277.3 million loss from the sale.

Although it is clear that receipt of the sale proceeds would have strengthened the seller’s immediate financial position, a former representative of the UK’s airport regulator, the Civil Aviation Authority (“CAA”), raised an interesting issue about the long-term financial impact on BAA of the decision to sell Gatwick Airport:

*“The proceeds of the sale of Gatwick Airport would help the company meet its financial obligations, though of course the long-term revenue entitlement from Gatwick’s asset base was lost at the same time as the debt was shed”* **(Former senior CAA employee)**

Price cap regulation in the UK is applied only to Gatwick, Heathrow, and Stansted airports. It is a single till approach in which the prices over 5 years are set at a level designed to recover:



- Operating costs
  - Return of capital (depreciation); and
  - Return on assets (RAB X cost of capital or Weighted Average Cost Of Capital);
- Less commercial income.

The two capital streams, return on capital and return of capital, represent streams of income which will cover investment costs.

Selling Gatwick meant that BAA no longer received those income streams in relation to Gatwick's assets.

In addition to the objectives of the seller, the presence of the CC as a triggering factor meant that its own objectives and intentions became relevant. Several stakeholders mentioned the involvement of the CC itself in the process.

*"The process was complicated by the involvement of the Competition Commission. The Competition Commission had to approve the final buyer and ensure, for example, that the buyer was operationally capable and financially viable."*  
**(Former member of BAA management and adviser to Gatwick Airport bidder)**

The CC's position in relation to Gatwick was somewhat unusual as the investigation into BAA had not yet been completed. In the case of a forced sale, the CC would normally appoint a trustee to oversee the sale, to ensure the intended development of competition is not in any way impeded by the seller. As this situation was different (the sale was not forced), the role of the CC was less clear. In the CC's final report in relation to BAA, the CC's role is described as follows:<sup>84</sup>

*"...the CC requires evidence to satisfy itself that prospective purchasers satisfy several criteria before they may be approved by the CC as 'suitable purchasers'. In summary, the CC considers that a suitable purchaser should be independent of BAA, should have appropriate expertise and financial resources to operate and develop Gatwick Airport as an effective competitor to other London airports and should not create further competitive concerns as a result of divestiture."*

It is interesting to contrast the CC's approach with the views of a former CAA employee who was interviewed. This representative explained that the CAA believes it should not generally concern itself with issues such as the identity or financing of owners (whether new or existing) of the airports it regulates.

*"In particular, the CAA should not take into account the financial viability of airport owners or their financing structures. Such risks should be borne by the investors with users being entirely isolated from them. As a result, instead of regulation taking into account acquisition financing, financing should take into account the existing regulatory framework."* **(Former senior CAA employee)**

It should be noted, of course, that the different approach these regulators took to involvement in the sale of Gatwick Airport is likely to be to some extent driven by the different issues which they were facing. In this particular case, the CC was clearly focused on ensuring effective competition in a

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<sup>84</sup> See Appendix 10.5 in Competition Commission, *BAA Airports Market Investigation - A report on the supply of airport services by BAA in the UK*, March 19, 2009.

sale which effectively pre-empted a forced sale, and felt a degree of operational and financial due diligence on potential buyers was appropriate from that perspective. The CC was concerned to ensure that the outcome did not act against the interests of users, or compromise the intended improvement in competition.

### **H.9.3 Transaction Process**

The transaction process took place at a time of significant uncertainty. It commenced before the financial downturn. However, as the economy worsened there were delays to the process as advisers sought to ensure a competitive number of bidders remained interested. The financial downturn had a negative impact on traffic, making it more difficult to value the airport as views had to be taken on the likely length of the downturn and the speed of the recovery. In addition, there was uncertainty about the location of new runways within the South-East of England. This presented an opportunity for the future acquirer of Gatwick Airport (a possible second runway at Gatwick) as well as a risk (a possible additional runway at a competing airport).

The transaction process was also complicated by two additional issues. First, as outlined above, the CC's involvement created an extra hurdle which bidders needed to clear, and stakeholders suggest there was some uncertainty about how and when the CC's involvement would impact bidders.

*"It was never clear exactly how and when the Competition Commission would utilize its 'veto' right" (Former member of BAA management and adviser to Gatwick Airport bidder)*

Second, Gatwick Airport had formed a part of BAA since BAA's inception, and there were a number of services which were either shared between Gatwick and BAA's other airports, or provided by a BAA-related entity to Gatwick.

*"More linkages than expected existed in areas such as IT and finance, and a number of technical service agreements needed to be agreed upon." (Gatwick Airport acquirer representative)*

However, a representative of Gatwick Airport's management team explained that the separation of Gatwick from BAA did not present as many difficulties as may initially have been anticipated:

*"In practice the transitional arrangements appeared to have worked reasonably well with goodwill and cooperation by both sides. In part this may reflect the fact that the parties involved on the ground were former colleagues who knew each other well, though it also remained in BAA's interests for Gatwick to succeed as an independent entity [given that there were other airports which might ultimately need to be sold]."* (Gatwick Airport management team representative)

The process was helped by good preparation -- even before the start of the sales process a number of steps had been taken towards the creation of a standalone entity.

*"A number of steps had already been taken to facilitate an eventual split both by the Competition Commission and BAA itself. The Competition Commission had been concerned to ensure that BAA did not take steps to weaken a potential competitor (by for example transferring out all of the staff with key skills). More positively, BAA had deliberately given Gatwick more latitude to expressly adopt its own public position on issues affecting it -- for example on consultations with the Government. It had also taken steps to deal with potential separation problems, by considering transition arrangements in the form of short-term contracts between Gatwick and BAA departments which*

*currently provided services such as financial reporting and IT.” (Gatwick Airport management team representative)*

Stakeholders also pointed out that, as this was a secondary sale, classic privatization issues such as pensions and job security received less focus and were generally easier to manage. In general terms, employees’ rights were protected under Transfer of Public Undertakings (“TUPE”) arrangements. Inevitably, there was some uncertainty for staff during the time of the sale process, but this was dealt with effectively by the new owner.

*“It had also been made clear to staff from the outset that their terms and conditions, including their very favorable pension scheme, would be continued.” (Gatwick Airport management team representative)*

**Timeline.** A summary of the transaction timeline is as follows:

**Table H.22. Timeline for Gatwick Transaction Process**

September 17, 2008	BAA announces the sale of Gatwick
January 19, 2009	Non-binding bids due. Six non-binding bids are received from: <ul style="list-style-type: none"> <li>• A consortium of Ontario Teachers’ Pension Plan, Canadian Pension Plan and 3i Infrastructure</li> <li>• Global Infrastructure Partners, owner of London City Airport</li> <li>• Gatwick Future Partnership, led by Babcock &amp; Brown and Deutsche Bank</li> <li>• Lysander Gatwick Investment, comprising Citigroup Infrastructure, Vancouver Airport Services and John Hancock Life Insurance</li> <li>• Hochtief AirPort, owner or part-owner of Hamburg, Dusseldorf, Sydney, Athens, Tirana and Budapest airports</li> <li>• The Manchester Airports Group, owner of Manchester, East Midlands, Humberside and Bournemouth airports, with Canadian infrastructure fund Borealis</li> </ul>
January 28, 2009	Hochtief pull out of the bidding process
February 2009	Two of the remaining five bidders pull out of the bid (The Gatwick Futures Partnership and 3i Consortium)
March 19, 2009	CC orders the sale of three airports within two years, forcing BAA to sell Gatwick, Stansted and Edinburgh or Glasgow
March 30, 2009	Original deadline for binding bids, but deadline is extended
April 27, 2009	New deadline for binding bids
Early May 2009	Lysander Gatwick Investment Group ejected from the bidding process
Mid May 2009	BAA rejects bid from GIP leaving only the Manchester Airports Group
Mid July 2009	The Manchester Airports Group walk away from bid over price disagreement
July 29, 2009	BAA says it does not need to sell Gatwick
August 2009	BAA re-enters sale discussions with GIP
October 21, 2009	BAA agree to sell Gatwick to GIP for £1.51 billion

### H.9.4 Economic Regulation

At the time of the transaction, Gatwick was subject to price regulation by the Civil Aviation Authority (CAA). Price caps are determined for regulatory periods of five years based on single till regulation.

The fact that the transaction was completed successfully at a value close to the airport’s regulatory asset base may be partially due to the well-established regulatory framework in place at the time of the sale.

*“This [the successful sale] could be regarded as an indication that the purchasers were able to gain significant comfort from the regulatory framework in place, which provides protection against a number of the risks to which Gatwick Airport was exposed – which at the time included gloomy traffic figures, the forthcoming likelihood of competition from main BAA and uncertainty on future Government airport policy.” (Former senior CAA employee)*

In late 2010, the regulatory framework was reviewed and it is planned that a license system, similar to that used for utilities in the UK, will be introduced, with greater flexibility for the regulator to set terms covering issues such as service, capital expenditure and financing, and an ability for the regulator to relax controls where they prove no longer to be necessary. It is possible that Gatwick, as a separate company competing for traffic, could be removed from regulation in due course. At the very least, there is scope for lessening the level of controls and moving towards some more light-handed form of regulation.

Nevertheless, at the time of the sale there was some speculation about future full or partial deregulation of Gatwick Airport. The CC’s main reason for requiring the sale of Gatwick Airport was to increase competition, and therefore deregulation seemed to a number of stakeholders a logical next step. Competition was unlikely to be fully effective if a third party controlled prices, and, to some extent, service and capital expenditure as well. Bidders indicated that they would have regarded deregulation as an upside scenario, as the benefits of deregulation are considered to be greater than the increased risks to which the airport would have been exposed. One stakeholder assessed the situation as follows:

*“In time, the separation of Gatwick from BAA may also have consequences for regulation. While complete deregulation is unlikely to occur in the short term, separate ownership may result in increased regulatory flexibility, especially when a constructive relationship with airlines exists.” (Gatwick Airport acquirer representative)*

And another stakeholder stated the following:

*“One of the longer-term consequences of the transaction over time may be full or partial deregulation. This would make sense as a key objective of this transaction was to create competition in the market. No doubt all bidders would have factored some upside associated with deregulation into their valuations.” (Former member of BAA management and adviser to Gatwick Airport bidder)*

The future of regulation of Gatwick Airport is not yet clear. As stakeholders explained, the removal of common ownership does not necessarily mean that there is sufficient competition to enable the removal of price cap regulation. The key limitation on competition among airports in the London system is lack of capacity, and until this issue was resolved there would be a continuing need for price regulation. However, the stakeholder added that this does not mean that the removal of common ownership has not had the intended benefit of increasing competition. Removing common ownership has introduced a new comparator for the regulator to take into account, enabling yardstick regulation and competition among regulated entities. This is regarded as particularly valuable from a service standards perspective.

## **H.9.5 Consequences**

Strong feedback was received from stakeholders in relation to impact of the transaction on Gatwick Airport and its users. Although almost all stakeholders felt it was too early to comment definitively on the impact of the transaction, the feedback received about changes to date was overwhelmingly

positive. However, rather than linking this specifically to the change in ownership, many linked this improved performance to the separation of Gatwick from BAA.

*“There have been a number of positive consequences resulting from this transaction, largely due to the fact that Gatwick Airport is now a standalone airport with a management team that gives the airport its full attention. Within BAA, Gatwick had to compete with Heathrow for management attention.” (Gatwick Airport acquirer representative)*

*“The acquisition by GIP has generally had a positive impact on Gatwick in comparison with its previous ownership by Ferrovial. Ferrovial’s focus was on Heathrow, and Gatwick did not receive much management attention. For this reason, it was possible for GIP to make a number of improvements almost overnight. The new management is clearly more focused on service quality and the customer experience.” (Former member of BAA management and adviser to Gatwick Airport bidder)*

Specific examples provided of improvements made include consolidation of security checkpoints in one location in the South Terminal. This project is expected to result in a much improved passenger experience at the airport, while overall capital expenditure savings are being made. An airline representative reported:

*“Feedback on passenger experience at Gatwick since the transaction has generally been positive. This appears to be an area of focus for the new owners.” (Gatwick Airport airline representative)*

Gatwick Airport management confirmed that enhancing service standards was one of the new owners’ key priorities:

*“On arriving at Gatwick they [the new owners] made clear that their priorities included establishing a distinct separate identity for the airport; improving efficiency; enhancing service; reviewing the capital expenditure plans to meet the needs of users more closely; and meeting the requirements of stakeholders.” (Gatwick Airport management team representative)*

Although this was not explicitly stated, the new owners are likely to see these priorities as giving gains in terms of positive future dealings with planning and regulatory bodies, as well as assisting in the marketing of the airport, and potentially (in terms of service in particular) improving retail performance.

In addition, airport management is focused on working with airlines to make sure that the capital expenditure plans that have been agreed upon can be delivered at lower costs, to the long-term benefit of airport users. More energy than previously is being invested into building a constructive relationship with Gatwick airlines, and this approach appears to be recognized by airlines:

*“Where previously decisions on matters such as capital expenditure were driven exclusively by BAA corporate goals, airlines are now consulted. Discussions can be confrontational, but it is better to have a confrontational relationship than to have no relationship at all. There is evidence that airline feedback is taken into account by the new owners, and there is now more correlation between capital expenditure plans and stakeholder preferences.” (Gatwick Airport airline representative)*

Such an approach is consistent with the treatment of capital expenditure which is embedded in UK regulation. The CAA’s role is to encourage economic investment, but it has no powers to determine

capital expenditure or impose investment programs on airport owners. This arrangement is regarded as beneficial, as it generally allows airports and airlines to work together to design an optimal capital program on commercial grounds.

The separation of Gatwick has other merits in regulatory terms:

*“There are likely to be new ideas and different approaches to doing things from an airport liberated from mainstream BAA. This is an advantage in its own right, and might be used by regulators as a means of challenging some of BAA’s long held approaches.” (Former senior CAA employee)*

This corresponds to the views we reported in the previous section about the benefits of having an additional comparator to enable yardstick regulation.

The above seems to suggest that significant benefits can be achieved simply by separating airport groups into standalone airports. The increased management focus has delivered a number of benefits for Gatwick Airport and its users. However, one stakeholder was keen to warn against drawing the conclusion that separation is always preferable:

*“This is not the same as saying that the sale of Gatwick was correct from a public policy standpoint. A different ownership structure to the Ferrovial-led consortium might have avoided the adverse impacts on Gatwick.” (Former member of BAA management and adviser to Gatwick Airport bidder)*

## H.9.6 Lessons Learned

The Gatwick Airport secondary sale took place in challenging circumstances. There were uncertainties associated with the decision on the location of the next runway in the London area, and economic conditions were challenging. For these reasons, it is generally seen as a significant achievement to achieve a sale in the face of these uncertainties. The lessons learned from this transaction include:

- The completion of the sale demonstrates that where investors can be convinced of the overall quality of an asset and the strength of its regulatory institutions, transactions can be achieved even in uncertain circumstances. However, the valuation achieved in such circumstances is likely to be lower.
- The transaction highlights the importance of a strong management team:

*“An airport’s ownership structure (private v. government ownership) does not have a significant impact on an airport’s business or an airport’s attractiveness to airlines. The key determinant is the strength of an airport’s management team, and its relationship with the airport owners. In the case of Gatwick, the key change in relationship is due to the airport’s move out of BAA and a new, dedicated, management being put in place.” (Gatwick Airport airline representative)*

- In addition, the successful separation of Gatwick from BAA reveals that the complexities associated with such a separation can be overcome.

*“Complex separation issues in a highly integrated company did not form an insoluble obstacle to a successful independent business.” (Gatwick Airport management team representative)*

- Several parties also provided opinions about the involvement of the CC. One stakeholder felt that it might have been helpful for the role of the CC to have been more clearly defined,

and in particular for the CC to have developed measures through which the impact of its involvement could have been evaluated:

*“From a public policy perspective, an interesting alternative approach may have been for the CC to have stated what consumer benefits it expected the Gatwick sale to generate then measure these after the event. For some service quality measures it could have implemented a performance bond, which would measure whether certain CC targets were met, and reward the winning bidder if this was the case (or penalize the winning bidder if this was not the case). The CAA’s work in this area could have been used as a starting point to define service quality measures.” (Former member of BAA management and adviser to Gatwick Airport bidder)*

The former CAA employee suggested that given similar responsibilities, the CAA might have approached the situation differently: The CAA would have been less inclined than the CC was to seek comfort on the financial viability of the new owner.

*“The CAA believes it is the responsibility of the new owner to ensure financial viability within the existing regulatory framework. In addition, regulators should not be unduly concerned about the operational credentials of a new owner. It is considered to be unlikely that people choosing to invest in an airport such as Gatwick would not either bring or hire the operational capability to run the airport.” (Former senior CAA employee)*

## H.9.7 References

Annual reports.

Competition Commission, *BAA Airports Market Investigation - A report on the supply of airport services by BAA in the UK*, March 19, 2009.

International Civil Aviation Organization, *Case Studies on Commercialization, Privatization and Economic Oversight of Airports and Air Navigation Services Providers (ANSPPS), Case Study: United Kingdom*, December 5, 2008.

Stakeholder interview with Competition Commission representative.

Stakeholder interview with for member of BAA airport management and adviser to Gatwick bidder.

Stakeholder interview with former regulator of Gatwick Airport.

Stakeholder interview with Gatwick Airport acquirer representative.

Stakeholder interview with Gatwick Airport airline representative.

Stakeholder interview with Gatwick Airport management team member.