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AIRPORT FINANCING

Annual Funding As Much As \$3 Billion Less Than Planned Development

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Mr. Chairman and Members of the Subcommittee:

We are here today to discuss airport funding issues. Over the last few years, your Committee and others have asked us to study these issues in considerable depth. Today's testimony focuses on three questions: (1) how much are airports spending on capital development and what are the sources of these funds? (2) if current funding levels continue, how do they compare with airports' plans for development? and (3) what effect will various proposals to increase or make better use of existing funding have on airports' ability to fulfill their capital development plans?

In summary,

- In 1998, we reported that the 3,304 airports that make up the federally supported national airport system obtained about \$7 billion from federal and private sources for capital development.¹ More than 90 percent of this funding came from three sources: tax-exempt bonds issued by states and local airport authorities (\$4.1 billion), federal grants from the Airport Improvement Program (\$1.4 billion), and passenger facility charges paid on airline tickets (\$1.1 billion).² The magnitude and type of funding varies with airports' size. The nation's 71 largest airports accounted for nearly 80 percent of the total funding. As a group, these airports are less dependent on federal grants: They received only about 10 percent of their funding from the Airport Improvement Program. By contrast, the 3,233 smaller airports in the national airport system relied on the Airport Improvement Program for half of their funding.
- Airports planned to spend as much as \$10 billion per year for capital development for the years 1997 through 2001, or \$3 billion per year more than they were able to fund in 1996. The difference between funding and the costs of planned development is greater for smaller commercial and general aviation airports than for their larger counterparts. Smaller airports' funding would cover only about half the costs of their planned development, while larger airports' funding would cover about 4/5 of their planned development. Airports' planned development can be divided into four main categories based on the funding priorities of the Federal Aviation Administration's (FAA) Airport Improvement Program. About \$1.4 billion per year was planned for safety, security, environmental, and

¹Airport Financing: Funding Sources for Airport Development (GAO/RCED-98-71, Mar. 12, 1998). This report was based on airport funding in 1996, the most recent year for which we have conducted an analysis.

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

reconstruction projects, FAA's highest priorities for Airport Improvement Program funding. Another \$1.4 billion per year was planned for projects FAA regards as the next highest priority, primarily adding airport capacity. Other projects FAA considers to be lower in priority, such as bringing airports up to FAA's design standards, add another \$3.3 billion per year. Finally, airports anticipated spending another \$3.9 billion per year on projects that are not eligible for Airport Improvement Program funding, such as expanding commercial space in terminals and constructing parking garages.

- Several proposals to increase or make better use of existing funding have emerged in recent years, including increasing the amount of Airport Improvement Program funding and raising the maximum amount airports can levy in passenger facility charges. Under current formulas, increasing the amount of Airport Improvement Program funding would help small airports more than larger airports, while raising passenger facility charges would help larger airports more. Other initiatives for making better use of existing funding, such as Airport Improvement Program block grants to states, have had varied success, but none appears to offer a major breakthrough in reducing the shortfall between funding and airports' plans for development.

Background

Airports are a linchpin in the nation's air transportation system. Adequate and predictable funding is needed for airport development. The National Civil Aviation Review Commission—established by Congress to determine how to fund U.S. civil aviation—reported in December 1997 that more funding is needed to develop the national airport system's capacity, preserve small airports' infrastructure, and fund new safety and security initiatives.³ Funding is also needed to mitigate the noise and other negative environmental effects of airports on nearby communities.

Airports provide important economic benefits to the nation and their communities. Air transportation accounted for \$63.2 billion, or 0.8 percent, of U.S. Gross Domestic Product in 1996, according to the Department of Transportation's statistics. 1.6 million people are employed at airports in 1998, according to the Airports Council International-North America. In our own study of airport privatization in 1996, we found that the 69 largest

³Avoiding Aviation Gridlock and Reducing the Accident Rate: A Consensus for Change, National Civil Aviation Review Commission (Dec. 1997).

U.S. airports had 766,500 employees (686,000 private and 80,500 public employees).⁴

Funding Sources Vary Depending on Airports' Size

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

Table 1: Sources of Funding for Airports

Dollars in billions			
Funding source	1996 amount	Percentage of total	Source of funds
Tax-exempt bonds	\$3.690 ^a	53	State and local governments or airport authorities issue tax-exempt bonds.
Airport Improvement Program (AIP)	\$1.372	20	The Congress makes funds available from the Airport and Airway Trust Fund, which receives revenues from taxes on domestic and international travel, domestic cargo transported by air, and noncommercial aviation fuel.
Passenger facility charges	\$1.114	16	Funds come from passenger fees of \$1, \$2, or \$3 per trip segment at commercial airports, up to a maximum of four trip segments per round trip.
Special facility bonds	\$.414	6	Issued on the behalf of beneficiaries other than airports, such as airlines.
State contributions	\$.285 ^b	4	Funds come from such sources as state aviation fuel and airline property taxes, aircraft registration fees, state bonds, and state general fund appropriations. The extent to which these sources are used varies by state.
Airport revenue	\$.153 ^c	2	Funds are generated from (1) revenues derived from the operation and landing of aircraft, passengers, or freight and (2) revenues derived from concessions and leases.
Total	\$7.028	100^d	

^aNet of refinancing.

^bState grants only. Amounts for local capital subsidies are unknown but, we believe, are minimal.

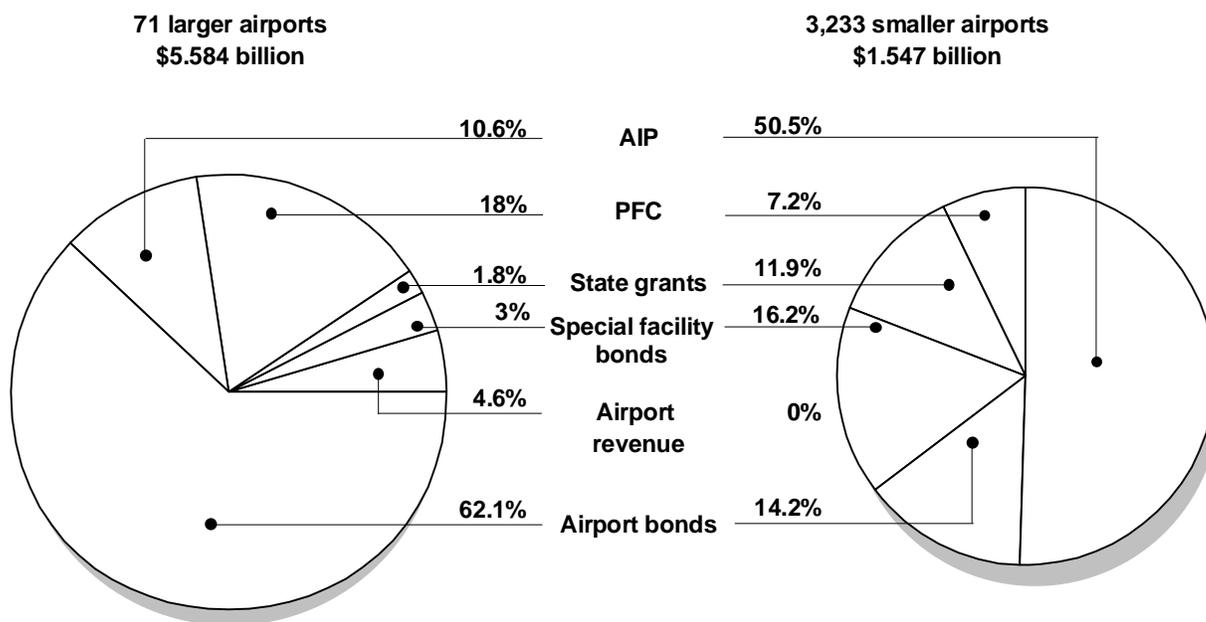
^cNet operating revenue in excess of a minimum coverage ratio of 125 percent of debt service (principal and interest payments).

^dMay not total 100 due to rounding.

⁴Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports (GAO/RCED-97-3, Nov. 7, 1996).

The amount and type of funding varies with airports' size. The nation's 71 largest airports (classified by FAA as large hubs and medium hubs), which accounted for almost 90 percent of all passenger traffic, received more than \$5.5 billion in funding in 1996, while the 3,233 other national system airports received about \$1.5 billion. As shown in figure 1, large and medium hub airports rely most heavily on private airport bonds, which account for roughly 62 percent of their total funding. By contrast, the 3,233 smaller national system airports obtained just 14 percent of their funding from bonds. For these smaller airports, AIP funding constitutes a much larger portion of their overall funding—about half.

Figure 1: Distribution of 1996 Funding Sources for Large and Medium Hub and Other National System Airports



Funding Levels Fall Short of Plans for Development

Airports' planned capital development over the period 1997 through 2001 may cost as much as \$10 billion per year, or \$3 billion more per year than in 1996. Figure 2 compares airports' total funding for capital development in 1996 with their annual planned spending for development. Funding for 1996, the bar on the left, is shown by source (AIP, PFCs, state grants, and operating revenues). Planned spending for future years, the bar on the

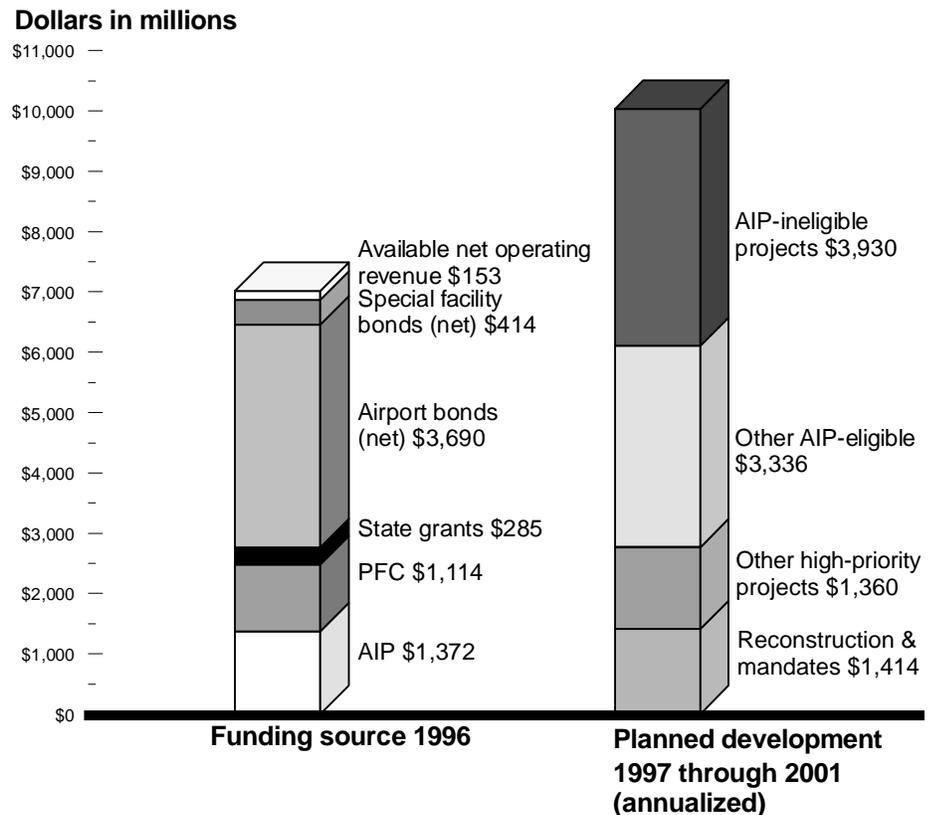
right, is shown by the relative priority FAA has assigned to the projects, as follows:⁵

- Reconstruction and mandated projects, FAA's highest priorities, total \$1.4 billion per year and are for projects to maintain existing infrastructure (reconstruction) or to meet federal mandates, including safety, security, and environmental requirements, including noise mitigation requirements.⁶
- Other high-priority projects, primarily adding capacity, account for another \$1.4 billion per year.
- Other AIP-eligible projects, a lower priority for FAA, such as bringing airports up to FAA's design standards, add another \$3.3 billion per year for a total of \$6.1 billion per year.
- Finally, airports anticipate spending another \$3.9 billion per year on projects that are not eligible for AIP funding, such as expanding commercial space in terminals and constructing parking garages.

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

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

Figure 2: 1996 Funding Compared With Planned Annual Development Costs



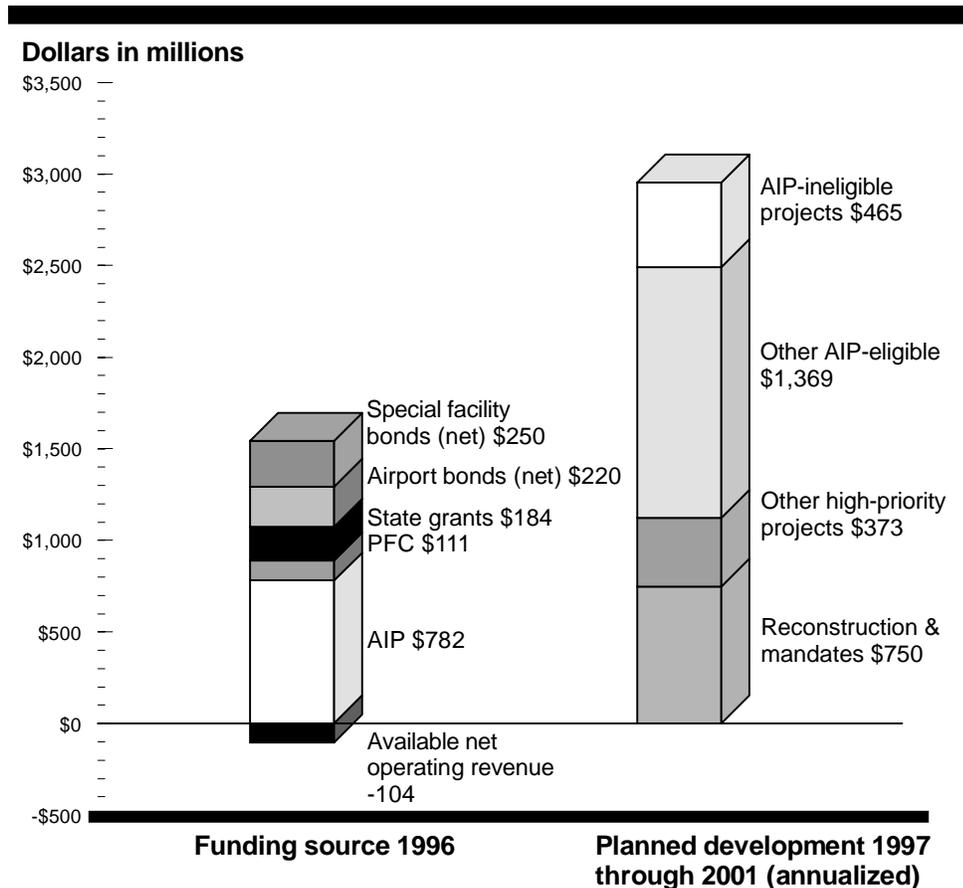
Within this overall picture of funding and planned spending for development, it is difficult to develop accurate estimates of the extent to which AIP-eligible projects are deferred or canceled because some form of funding cannot be found for them. FAA does not maintain information on whether eligible projects that do not receive AIP funding are funded from other sources, deferred, or canceled. We were not successful in developing an estimate from other information sources, mainly because comprehensive data are not kept on the uses to which airport and special facility bonds are put. But even if the entire bond financing available to smaller airports were spent on AIP-eligible projects, these airports would have, at a minimum, about \$945 million a year in AIP-eligible projects that are not funded. Conversely, if none of the financing from bonds were applied to AIP-eligible projects, then the full \$3 billion funding shortfall would apply to these projects.

Funding Difference at Smaller Airports Is More Significant Than at Larger Airports

The difference between current and planned funding for development is bigger, in percentage terms, for smaller airports than for larger ones. Funding for the 3,233 smaller airports in 1996 was a little over half of the estimated cost of their planned development, producing a difference of about \$1.4 billion (see fig. 3). This difference would be even greater if it were not for \$250 million in special facility bonding for a single cargo/general aviation airport.⁶ For this group of airports, the \$782 million in 1996 AIP funding exceeds the annual estimate of \$750 million for FAA's highest-priority projects—those involving reconstruction, noise mitigation, and compliance with federal mandates. However, there is no guarantee that the full amount of AIP funding will go only to the highest-priority projects, because one-third of AIP funds are awarded to airports on the basis of the number of passengers boarding commercial flights and not necessarily on the basis of projects' priority.

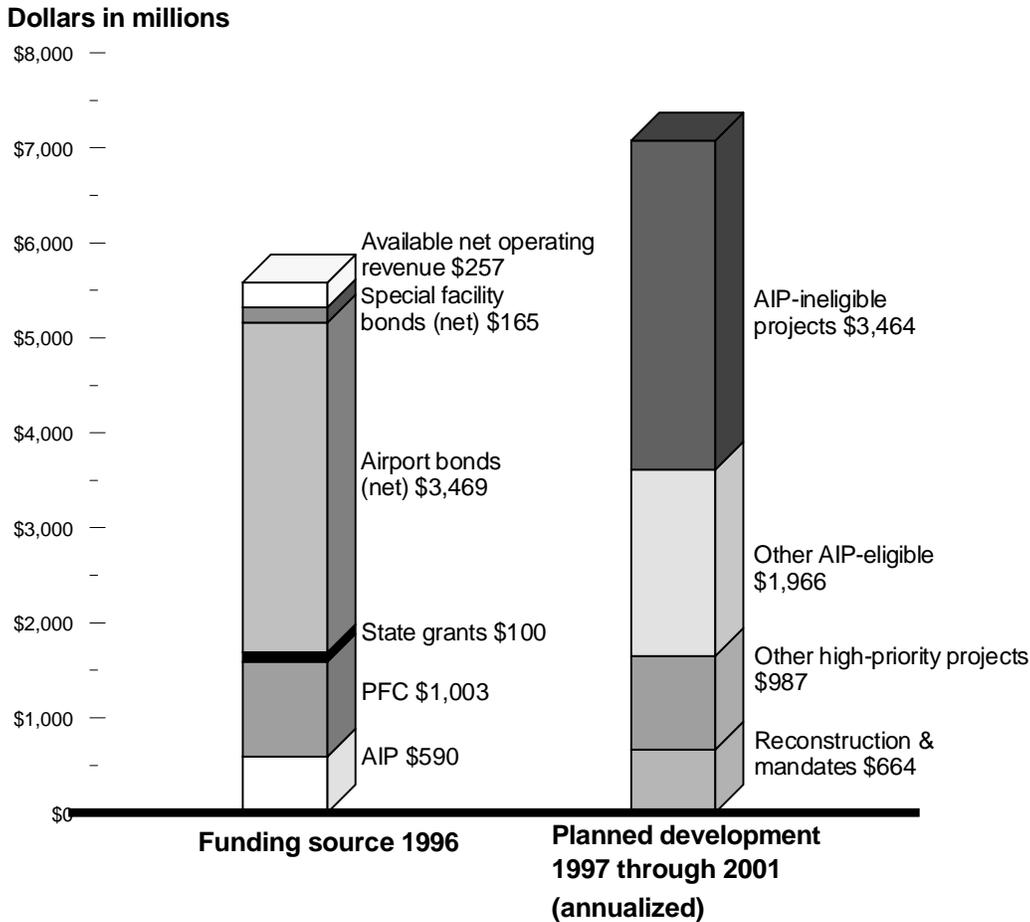
⁶Fort Worth Alliance Airport, a general aviation-cargo airport, issued \$250 million in special facility bonds in 1996.

Figure 3: 1996 Funding Compared to Annual Planned Development Costs for Smaller Airports



As a proportion of total funding, the potential funding difference between 1996 funding and planned development for the 71 large and medium hub airports is comparatively less than for their smaller counterparts (see fig. 3 and fig. 4). Larger airports potential shortfall of \$1.5 billion represents 21 percent of their planned development costs, while smaller airports' potential shortfall of \$1.4 billion represents 48 percent of their development costs. Therefore, while larger and smaller airports' respective shortfalls are similar in size, the greater scale of larger airports' planned development causes them to differ considerably in proportion. Figure 4 also indicates that \$590 million in AIP funding falls \$74 million short of the estimated cost to meet FAA's highest priorities for development—reconstruction, noise mitigation, and compliance with federal mandates.

Figure 4: 1996 Funding Compared to Annual Planned Development Costs for Large and Medium Hub Airports



Effect of Proposals to Increase and Better Use Airport Funding Is Mixed

Proposals to increase airport funding or make better use of existing funding vary in the extent to which they would help different types of airports and close the gap between funding and the costs of planned development. For example, increasing AIP funding would help smaller airports more because current funding formulas would channel an increasing proportion of AIP to smaller airports. Conversely, any increase in PFC funding would help larger airports almost exclusively because they handle more passengers and are more likely to have a PFC in place. Changes to the current design of AIP or PFCs could, however, lessen the concentration of benefits to one group of airports. FAA has also used other

mechanisms to better use and extend existing funding sources, such as letters of intent, state block grants, and pilot projects to test innovative financing. So far, these mechanisms have had mixed success.

Increasing AIP Would Help Smaller Airports Most

Under the existing distribution formula, increasing total AIP funding would proportionately help smaller airports more than large and medium hub airports. Appropriated AIP funding for fiscal year 1998 was \$1.7 billion; large and medium hub airports received nearly 40 percent and all other airports about 60 percent of the total.⁷ We calculated how much funding each group would receive under the existing formula, at funding levels of \$2 billion and \$2.347 billion. We chose these funding levels because the National Civil Aviation Review Commission and the Air Transport Association (ATA), the commercial airline trade association, have recommended that future AIP funding levels be stabilized at a minimum of \$2 billion annually, while two airport trade groups—the American Association of Airport Executives and the Airports Council International-North America—have recommended a higher funding level, such as AIP’s authorized funding level of \$2.347 billion for fiscal year 1998. Table 2 shows the results. As indicated, smaller airports’ share of AIP would increase under higher funding levels if the current distribution formula were used to apportion the additional funds.

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

Dollars in millions

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

^aDollar amounts are based on the number of passengers boarding commercial flights in 1996 and exclude about \$105.2 million in estimated carryover amounts.

^bThe distribution of funds were based on the proportional distribution of those funds during fiscal year 1997, the first year under the revised distribution formula established in the 1996 reauthorization.

⁷Fiscal year 1999 AIP funding is \$1.95 billion, though AIP is authorized only through Mar. 31, 1999, and, therefore, not more than \$975 million may be obligated until AIP is further extended. (Title I, section 101(g) of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (P.L. 105-277, Oct. 21, 1998)).

Increasing PFC-Based Funding Would Aid Larger Airports

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

If the airports currently charging PFCs were permitted to increase them beyond the current \$3 ceiling, total collections would increase from the \$1.35 billion that FAA estimates was collected during 1998. Most of the additional collections would go to larger airports. For every \$1 increase in the PFC ceiling, we estimate that large and medium hub airports would collect an additional \$432 million, while smaller airports would collect an additional \$46 million (see fig. 5). In total, a \$4 PFC ceiling would yield \$1.9 billion, a \$5 PFC would yield \$2.4 billion, and a \$6 PFC would yield \$2.8 billion in total estimated collections.¹⁰

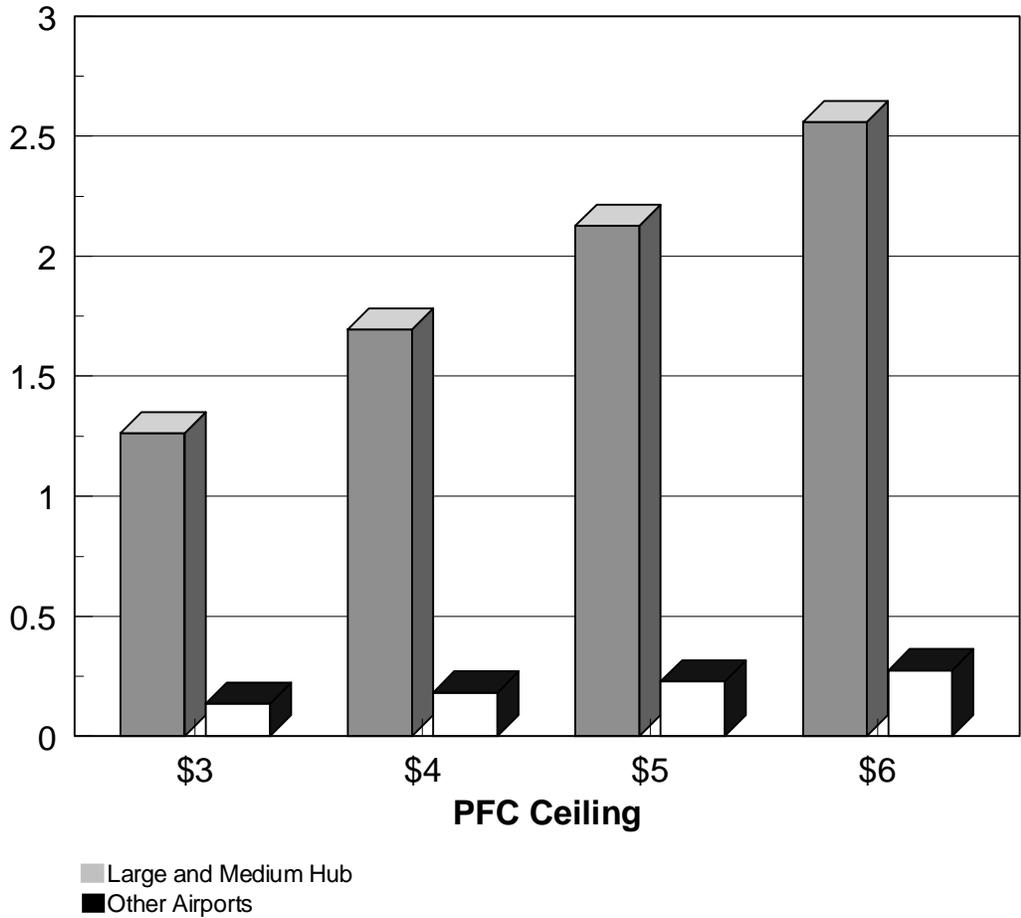
⁸As of Oct. 1, 1998, 273 commercial service airports—about 52 percent of eligible airports—imposed a PFC, but 80 percent of all large and medium hub airports had a PFC.

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

¹⁰Estimates are based on PFCs in place as of Oct. 1, 1998, 1997 passenger boardings, and median collection rates for each airport category in 1997. We are currently studying the effects of a PFC increase and plan to report our results later this year.

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

Dollars in billions



Increased PFC funding is likely to be applied to different types of projects than would increased AIP funding. Most AIP funding is applied to “airside” projects like runways and taxiways. “Landside” projects, such as terminals and access roads, are lower on the AIP priority list. However, for some airports, congestion may be more severe at terminals and on access roads than on airfields, according to airport groups.¹¹

¹¹FAA measures airfield congestion and delays but does not gather information on congestion on access roads or in terminals.

The majority of PFCS are currently dedicated to terminal and airport access projects and interest payments on debt, and any additional revenue from an increase in PFCS may follow suit.

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

In recent years, the Congress has directed FAA to undertake other steps designed to allow airports to make better use of existing AIP funds. Thus far, some of these efforts, such as letters of intent and state block grants, have been successful. Others, such as pilot projects to test innovative financing and privatization, have received less interest from airports and are still being tested. Finally, one idea, using AIP grants to capitalize state revolving loan funds, has not been attempted but could help small airports. Implementing this idea would require legislative changes.

Letters of Intent Are an Important Source of Funding for Larger Airports

Letters of intent are an important source of long-term funding for airport capacity projects, especially for larger airports. These letters represent a nonbinding commitment from FAA to provide multiyear funding to airports beyond the current AIP authorization period. Thus, the letters allow airports to proceed with projects without waiting for future AIP grants and provide assurance that allowable costs will be reimbursed. Airports may also be able to receive more favorable interest rates on bonds that are sold to finance a project if the federal government has indicated its support for the project in a letter of intent. For a period, FAA stopped issuing letters of intent, but since January 1997, it has issued 10 letters with a total funding commitment of \$717.5 million. Currently, FAA has 28 open letters committing a total of \$1.180 billion through 2010.¹² Letters of intent for large and medium airports account for \$1.057 billion, or 90 percent, of that total. Airports' demand for the letters continues—FAA expects at least 10 airports to apply for new letters of intent in fiscal year 1999.

State Block Grant Program Has Helped Smaller Airports

In 1996, we testified before this Subcommittee that FAA's state block grant pilot program was a success.¹³ The program allows FAA to award AIP funds in the form of block grants to designated states, that, in turn, select and fund AIP projects at small airports. States then decide how to distribute these funds to small airports. In 1996, the program was expanded from seven to nine states and made permanent. Both FAA and the participating states believe that they are benefiting from the program.

¹²Airport Improvement Program: Planned Funding Under Letters of Intent (GAO/RCED-99-33R) Dec. 9, 1998.

¹³Airport Improvement Program: State Block Grant Pilot Program Is a Success (GAO/RCED-96-86) Mar. 14, 1996.

Benefits of Innovative Financing Are Being Tested

In recent years, FAA, with congressional urging and direction, has sought to expand airports' available capital funding through more innovative methods, including the more flexible application of AIP funding and efforts to attract more private capital. The 1996 Federal Aviation Reauthorization Act gave FAA the authority to test three new uses for AIP funding—(1) projects with greater percentages of local matching funds, (2) interest costs on debt, and (3) bond insurance. In all, these three innovative uses could be tested on up to 10 projects.¹⁴ Another innovative financing mechanism that we've recommended—using AIP funding to help capitalize state airport revolving funds—while not currently permitted, may hold some promise.¹⁵

FAA is testing 10 innovative uses of AIP funding totaling \$24.16 million, all at smaller airports. Five projects tested the benefits of the first innovative use of AIP funding—allowing local contributions in excess of standard matching amount, which for most airports and projects is otherwise fixed at 10 percent of the AIP grant.¹⁶ FAA and state aviation representatives generally support the concept of flexible matching because it allows projects to begin that otherwise might be postponed for lack of sufficient FAA funding; in addition, flexible funding may ultimately increase funding to airports. The latter five projects test the other two mechanisms for innovative financing. Applicants have generally shown less interest in the latter two options, which, according to FAA officials, warrant further study.

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

Some federal transportation, state aviation, and airport bond rating and underwriting officials believe using AIP funding to capitalize state revolving loan funds would help smaller airports obtain additional financing. Currently, FAA cannot use AIP funds for this purpose because AIP construction grants can go only to designated airports and projects. However, state revolving loan funds have been successfully employed to

¹⁴Section 148 of the Federal Aviation Reauthorization Act of 1996 (P.L. 104-264).

¹⁵Airport Financing: Funding Sources for Airport Development (GAO/RCED-98-71, Mar. 12, 1998).

¹⁶There are three exceptions to the 10-percent local matching requirement, each of which entails a higher local contribution: terminal development (25 percent), airport planning and development for large and medium hub airports (25 percent), and noise compatibility programs for large and medium hub airports (20 percent).

finance other types of infrastructure projects, such as wastewater projects and, more recently, drinking water and surface transportation projects.¹⁷

While loan funds can be structured in various ways, they use federal and state moneys to capitalize the funds from which loans are then made. Interest and principal payments are recycled to provide additional loans. Once established, a loan fund can be expanded through the issuance of bonds that use the fund's capital and loan portfolio as collateral. These revolving funds would not create any contingent liability for the U.S. government because they would be under state control.

Interest in Airport Privatization Pilot Program Is Limited

Declining airport grants and broader government privatization efforts spurred interest in airport privatization as another innovative means of bringing more capital to airport development, but thus far efforts have shown only limited results. As we previously reported, the sale or lease of airports in the United States faces many hurdles, including legal and economic constraints.¹⁸ As a way to test privatization's potential, the Congress directed FAA to establish a limited pilot program under which some of these constraints would be eased.¹⁹ Starting December 1, 1997, FAA began accepting applications from airports to participate in the pilot program on a first-come, first-served basis for up to five airports. Thus far, two airports have applied to be part of the program.²⁰

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

¹⁷Florida has an established revolving loan program. Between 1985 and 1998, the state has provided \$75 million in loans to airports for land acquisition and capital projects. While some of the loans are later reimbursed through AIP funding for eligible projects, the state funds the loan program itself. In addition, the Virginia legislature is considering establishing a state airport revolving fund. In total, 39 states have established state infrastructure banks using federal and state grant money to fund surface transportation projects. This same arrangement could be used if authorized by the state to fund aviation projects, and at least one state—Ohio—has already authorized its state infrastructure bank to fund aviation projects with state funds.

¹⁸Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports (GAO/RCED-97-3, Nov. 7, 1996).

¹⁹Section 149 of the Federal Aviation Reauthorization Act of 1996 (P.L. 104-264).

²⁰These airports are Brown Field near San Diego, a general aviation airport, and Stewart International in New York, a nonhub airport, which has submitted its final application.

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