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AIRPORT FINANCE

Preliminary Analysis Indicates Proposed Changes in the Airport Improvement Program May Not Resolve Funding Needs for Smaller Airports

Statement of Gerald L. Dillingham, Ph.D
Director, Physical Infrastructure

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Highlights

Highlights of GAO-07-617T, a testimony to Before the Subcommittee on Aviation, House Committee on Transportation and Infrastructure

Why GAO Did This Study

To address the strain on the aviation system, the Federal Aviation Administration (FAA) has proposed transitioning to the Next Generation Air Transportation System (NextGen). To finance this system and to make its costs to users more equitable, the administration has proposed fundamental changes in the way that FAA is financed.

As part of the reauthorization, the administration proposes major changes in the way that grants through the Airport Improvement Program (AIP) are funded and allocated to the 3,400 airports in the national airport system. In response, GAO was asked for an update on current funding levels for airport development and the sufficiency of those levels to meet planned development costs. This testimony comprises capital development estimates made by FAA and Airports Council International (ACI), the chief industry association; analyzes how much airports have received for capital development and whether this is sufficient to meet future planned development; and summarizes the effects of proposed changes in funding for airport development.

This testimony is based on ongoing GAO work. Airport funding and planned development data are drawn from the best available sources and have been assessed for their reliability.

This testimony does not contain recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-07-617T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Gerald L. Dillingham at (202) 512-2834 or DillinghamG@gao.gov.

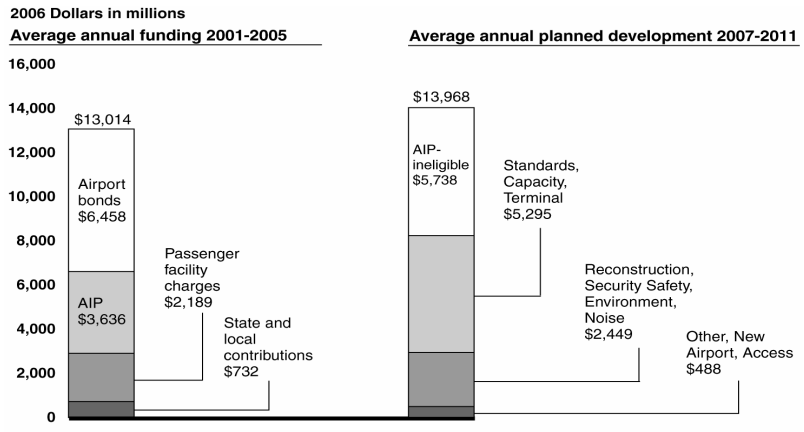
What GAO Found

ACI's estimate for planned development costs is considerably larger than FAA's, reflecting a broader range of projects included as well as differences in when and how the estimates are made. For 2007 through 2011, FAA estimated annual planned capital development costs at $8.2 billion, while ACI estimated annual costs at $15.6 billion. The estimates differ primarily because FAA's estimate only includes projects that are eligible for AIP grants, while ACI's covers all projects, including $5.8 billion for projects not eligible for federal funding, such as parking garages.

From 2001 through 2005, airports received an average of about $13 billion a year for planned capital development. This amount covers all types of projects, including those not eligible for federal grants. The primary source of this funding was bonds, which averaged almost $6.5 billion per year, followed by federal grants and passenger facility charges (PFC), which accounted for $3.6 billion and $2.2 billion, respectively (see figure below). If airports continue to attract this level of funding for planned capital development, this amount would annually fall about $1 billion short of the $14 billion in total planned development costs (the sum of FAA's estimated $8.2 billion in eligible costs and the industry's $5.8 billion in ineligible costs). Larger airports foresee a shortfall of about $600 million annually, while smaller airports foresee a shortfall of $400 million annually.

FAA's reauthorization proposal would reduce the size of AIP by $750 million but increase the amount that airports can collect from PFCs. However, the benefit from increased PFCs would accrue mostly to larger airports and may not offset a reduced AIP grants program for smaller airports. The proposal would also change the way that AIP and other FAA programs are funded. The new fuel taxes that FAA has proposed may not provide the revenues for AIP that FAA anticipates.

Comparison of Historical Airport Funding to Future Development Costs



Sources: GAO analysis of FAA, ACI, Thomson Financial, and state grant data.

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to testify before you today as you consider the Federal Aviation Administration's (FAA) reauthorization proposal including the Airport Improvement Program (AIP) for fiscal years 2008-2010.[1]

Once again, the nation's airports are having to cope with capacity issues. Air traffic has risen back above pre-September 11 levels, as has the level of delays. FAA operates one of the safest air transportation systems in the world, but it is also a system under strain. Already last year, one in four flights was subject to flight delays. In addition, the system is expected to absorb a variety of new and differing aircraft in the future, ranging from the jumbo Airbus A380, which can hold more than 500 passengers, to very light jets, which carry only a few passengers and could greatly increase the number of aircraft in the air. Demand for air travel is expected to reach 1 billion passengers by 2015, according to FAA estimates. The consensus of opinion is that the current aviation system cannot expand to meet this projected growth. FAA is developing a modernization program for its air traffic control system called the Next Generation Air Transportation System (NextGen) to accommodate this growth. To fund this system, FAA has proposed relying on a cost-based system using airline user fees and fuel taxes instead of passenger ticket taxes and other excise taxes that are due to expire at the end of September 2007. In regard to airports, the administration is proposing $2.75 billion to fund the AIP program—which is substantially less than the current level—and changing the way that grants to the 3,400 airports in the national airport system are funded and allocated under AIP. The administration's proposal would also allow commercial airports to impose higher passenger facility charges (PFC) to pay for capital projects.[2]

[1]The FAA administers federal funds for airport capital improvements through grants awarded from the Airport and Airway Trust Fund under the AIP.

[2]The PFC Program allows the collection of PFC fees up to $4.50 for every enplaned passenger at commercial airports controlled by public agencies. Airports use these fees to fund FAA-approved projects that enhance safety, security, or capacity; reduce noise; or increase air carrier competition.

In anticipation of this year's reauthorization of FAA, you asked for an update on airports' current funding levels from our previous reports,[3] the sufficiency of those levels to meet planned development, and how the administration's proposed reauthorization will affect airports. For this update, we are providing preliminary responses to these key questions:

- How do FAA and Airports Council International (ACI) estimates of capital development compare?
- How much have airports received for capital development and where is the money coming from?
- If current funding levels continue, will they be sufficient to meet planned capital development costs for 2007 through 2011?
- What are some of the potential effects of changes in how airport development will be funded as part of the administration's FAA reauthorization legislation?

To determine how much planned development would cost over the next 5 years, we obtained planned capital development data from FAA and ACI, a key industry association. To determine the sources of airport funding, we obtained capital funding data from FAA, the National Association of State Aviation Officials (NASAO) and Thomson Financial, a firm that tracks all municipal bond issues. We obtained funding data from 2001 through 2005 because these were the most recent years for which consistent data were available and then adjusted the amounts for inflation to 2006 dollars so that they could be compared to planned development amounts, which are also expressed in 2006 dollars. We screened the planned development and funding data for accuracy and compared funding streams across databases where possible. We did not, however, audit how the databases were compiled. To compare the estimates between FAA and industry, we reconciled survey data and identified areas where the largest differences occur. We reviewed the reliability of these data and concluded that they were sufficiently reliable for our purposes.

[3]In 2003 and 1998, GAO reported on airport financing. See *Airport Finance: Past Funding Levels May Not Be Sufficient to Meet Airports' Planned Capital Development*, GAO-03-497T (Washington D.C.: Feb. 25, 2003) and *Airport Financing: Funding Sources for Airport Development*, GAO/RCED-98-71 (Washington D.C.: Mar. 12, 1998).

We conducted our work from August 2006 to March 2007 in accordance with generally accepted government auditing standards. More details about the scope and the methodology of our work are presented in appendix II.

In summary:

- ACI's estimate of planned development costs is considerably larger than FAA's, reflecting the broader range of projects included as well as differences in when and how the estimates are reported. For 2007 through 2011, FAA estimated annual planned capital development costs at $8.2 billion, while ACI estimated annual costs at $15.6 billion, a difference of $7.4 billion annually. The estimates differ primarily because FAA's estimate includes only projects that are eligible for federal airport improvement grants, while ACI's includes all projects, including those that may not be eligible for federal grants. Types of projects not eligible for federal grants include parking garages and commercial space in terminals. However, even when comparing only AIP-eligible projects, ACI's estimate exceeds FAA's by $1.6 billion annually because of differences in the definition, measurement, and timing of projects.

- From 2001 through 2005, airports received an average of about $13 billion a year for planned capital development from a variety of funding sources. This includes funding for all types of projects, including those not eligible for AIP grants. The primary source of this funding was municipal bond proceeds (backed primarily by airport revenues), which averaged almost $6.5 billion per year, followed by AIP and PFCs which accounted for $3.6 billion and $2.2 billion, respectively. The 67 larger airports, which account for 90 percent of passengers, rely more heavily on bond financing to fund their development, while the other approximately 3,300 smaller airports in the national system are more reliant on federal grants.[4]

- The total of FAA and ACI estimates of planned development for 2007 through 2011 exceeds historical funding levels by about $1 billion annually. The difference between past funding and future development plans is not the same for larger and smaller airports. The 67 larger airports averaged $9.4 billion annually in funding, as compared to $10 billion

[4]We will follow conventions established in GAO's prior report on airport finance in differentiating between larger (large and medium hub airports) and smaller (all other categories of commercial and general aviation airports). See *Airport Finance: Past Funding Levels May Not Be Sufficient to Meet Airports' Planned Capital Development*, GAO-03-497T (Washington D.C.: Feb. 25, 2003).

annually in AIP-eligible and ineligible projects—a difference of $600 million annually. All other airports, including general aviation airports, averaged $3.6 billion annually in funding, as compared to $4 billion annually in AIP-eligible and ineligible project, a difference of $400 million annually.

- The administration's reauthorization proposal would provide more money to larger airports through an increase in PFCs, but its impact on smaller airports is uncertain because these airports are more reliant on AIP, whose funding level is being reduced and whose allocation is being changed. The proposal would reduce the AIP grants program by $750 million (or more than 20 percent of its current level) but increase the amount that airports can collect from PFCs from $4.50 per passenger to $6.00 per passenger, potentially increasing larger airports' collections by $1.1 billion. For smaller airports that collect far less from PFCs, the increase in PFCs may not compensate for the overall reduction in AIP, especially for general aviation airports that have no ability to collect PFCs. As a separate issue, the administration's reauthorization proposal would also change the way that AIP and other FAA programs are funded. The new fuel taxes that have been proposed to fund AIP and other programs may not generate the amount of revenue that is anticipated and additional sources of revenue may have to be found.

The Size and Scope of FAA and ACI Airport Capital Estimates Differ

ACI's estimate of planned capital development costs is considerably larger than FAA's because it reported a broader base of projects. According to FAA's estimate, which includes only projects that are eligible for AIP grants, the total cost of airport development will be about $41 billion, or about $8.2 billion per year for 2007 through 2011. (See table 1.) ACI estimates annual costs of about $78 billion, or about $15.6 billion per year, for the same period. These estimates differ mainly because ACI's estimate includes all future projects that may or may not have an identified funding source or be eligible for federal funding and also because they are based on different estimating approaches. Projects that are eligible for AIP grants include runways, taxiways, and noise mitigation and reduction efforts; projects that are not eligible for AIP funding include parking garages, hangars, and expansions of commercial space in terminals.

Table 1: Average Annual Planned Development Costs Estimated by FAA and ACI, by Airport Type, 2007-2011

Dollars in millions			
		Estimated average annual costs	
Airport Type	Number of Airports	FAA	ACI
Larger Airports			
Large hub	30	$3,414	$8,280
Medium hub	37	933	3,066
Subtotal	**67**	**4,347**	**11,346**
Smaller airports			
Small hub	72	629	1,146
Non hub	243	840	840[a]
Other commercial service	135	146	146[a]
Reliever	274	579	579[a]
General aviation	2574	1,528	1,528[a]
New airports	67	111	-
Subtotal	**3,365**	**3,833**	**4,239**
Total	**3,432**	**$8,180**	**$15,585**

Source: GAO analysis of FAA and ACI data

[a]ACI's estimate for these categories of airports is drawn directly from FAA's estimate.

Attempts to Reconcile ACI and FAA Estimates of Planned Development Costs Illustrate Differences

Several factors account for the differences between the FAA and ACI estimates of future development costs. The biggest difference stems from ACI's inclusion of projects that are not eligible for AIP grants, while FAA's estimate includes only AIP-eligible projects (see table 2). However, even when comparing just the AIP-eligible portions of the respective estimates, ACI's estimate is 20 percent ($8 billion in total or $1.6 billion annually) greater. This points to differences in how the two estimates are formed.

Table 2: Comparison of ACI and FAA Estimates of Planned Development for 2007-2011 (Dollars in billions)

Source	Total	For all airports surveyed	For large hubs surveyed	For medium hubs surveyed	For small hubs surveyed
ACI total estimate	**$78**	$51	$36	$11.3	$2.0
Less: AIP-ineligible or unknown	**29**	23	15.2	6.6	.8
ACI AIP-eligible portion	**49**	28[a]	21.2	4.6	1.2
FAA Estimate of AIP-eligible	**41**	21	15.7	3.4	1.3
Difference	**$8**	$7	$5.5	$1.2	$.6

Source: GAO analysis of FAA and ACI data.

[a]Total for large, medium, and small hub airports does not equal all airports surveyed because ACI also surveyed a few GA and nonhub airports.

One difference is the estimating approach. FAA's estimates cover projects for every airport in the national system, while ACI surveyed the 100 largest airports (mostly large and medium hub airports) and then extrapolated a total based on cost per enplanement calculations for small, medium, and large hub airports that did not respond.

Further analysis on a project-by-project level shows variances related to three other factors:

- **Definition**—FAA data are based on planned project information taken from airport master plans and state system plans, minus projects that already have an identified funding source, while ACI includes all projects, whether funding has been identified or not. For example, ACI's estimate for Washington Dulles airport includes $278 million for an automated people mover, but FAA's estimate does not because it is being funded by a PFC approved in 2006.

- **Measurement**—FAA data include only the portion of a project that is eligible for AIP, while ACI estimates the total value project cost. On a terminal construction project at Dulles International Airport, ACI estimated total costs of $1.6 billion for construction; however, only a small portion is eligible for AIP funding. FAA did not report any amount because under FAA AIP rules only a small portion ($20 million) was eligible for AIP funding and the airport had exhausted the AIP funds that could be used for

this type of project.

- **Timing**—The ACI and FAA estimated planned development costs for the same five year time period, but the estimates were made at different times—the ACI survey was completed in early 2007, while FAA's estimate is based on information collected in early 2006. Further, the ACI estimate includes projects that FAA does not believe will be commissioned during the next 5 years. At Fort Lauderdale International Airport, for example, ACI reported a $700 million runway project but FAA reports less than $200 million for the same project. According to FAA, the remaining costs are beyond 2011.

  FAA and ACI estimates do not consider cost increases such as rising construction costs. Going forward these costs may increase, especially construction costs which have jumped 26 percent in 30 major U.S. cities over the past three years. Industry experts predict that construction costs will continue to increase project costs.-FAA acknowledges that development estimates may or may not include increase in costs based on construction uncertainty and that annual costs increases are not captured.

Airports Have Averaged About $13 Billion Annually in Capital Financing over the Last 5 Years and Use a Variety of Funding Sources

From 2001 to 2005, the 3,364 active airports that make up the national airport system received an average of about $13 billion per year for planned capital development from a variety of funding sources. These funds are used for both AIP-eligible and ineligible projects. The single largest source of these funds was bond proceeds, backed primarily by airport revenues, followed by AIP grants, PFCs, and state and local contributions (see table 3).

Table 3: Sources of Airport Funding, 2001- 2005

2006 Dollars in billions			
Funding Source	**2001-2005 average annual funding**	**Percent of total**	**Source of funds**
Airport bonds	$6.5[a]	50	State and local governments or airport authorities issue tax-exempt debt
AIP grants	3.6[b]	29	The Congress makes funds available from the Airport and Airway Trust Fund, which receives revenue from various aviation-related taxes
Passenger facility charges	2.2[c]	17	Funds come from passenger fees of up to $4.50 per trip segment at commercial airports
State and local contributions	.7	4	Funds include state and local grants, loans, and matching funds for AIP grants
Total	**$13**	**100**	

Source: GAO analysis of FAA, Thomson Financial, and state grant data

Note: Totals may not add because of rounding.

[a]Net of refinancing.

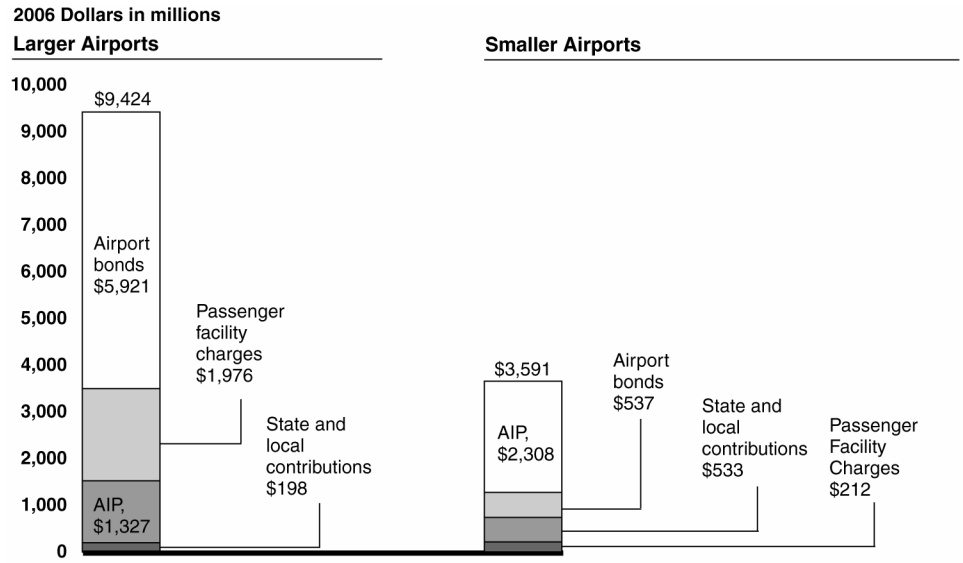
[b]AIP totaled on a fiscal year basis.

[c]Some airports use their PFCs to finance bond issues, as much as 30 percent of PFC collections by some estimates. As a result, the total amount of funds available to airports may be overstated by as much as $660 million (30 percent of $2.2 billion).

The amount and source of funding vary with the size of airports. The nation's 67 larger airports, which handled almost 90 percent of the passenger traffic in 2005, accounted for 72 percent of all funding ($9.4 billion annually), while the 3,297 other smaller commercial and general aviation airports that make up the rest of the national system accounted for the other 28 percent ($3.5 billion annually).[5] As shown in figure 1, airports' reliance on federal grants is inversely related to their size—federal grants contributed a little over $1.3 billion annually to larger airports (14 percent of their total funding) and $2.3 billion annually to smaller airports (64 percent of their total funding).

[5]As noted in Table 3, the total amount of funds may be somewhat overstated because as much as 30 percent of PFCs are used to finance bond issues. This would particularly affect the total for larger airports, which collect most of the PFCs.

Figure 1: Funding Sources by Size of Airport, 2001-2005



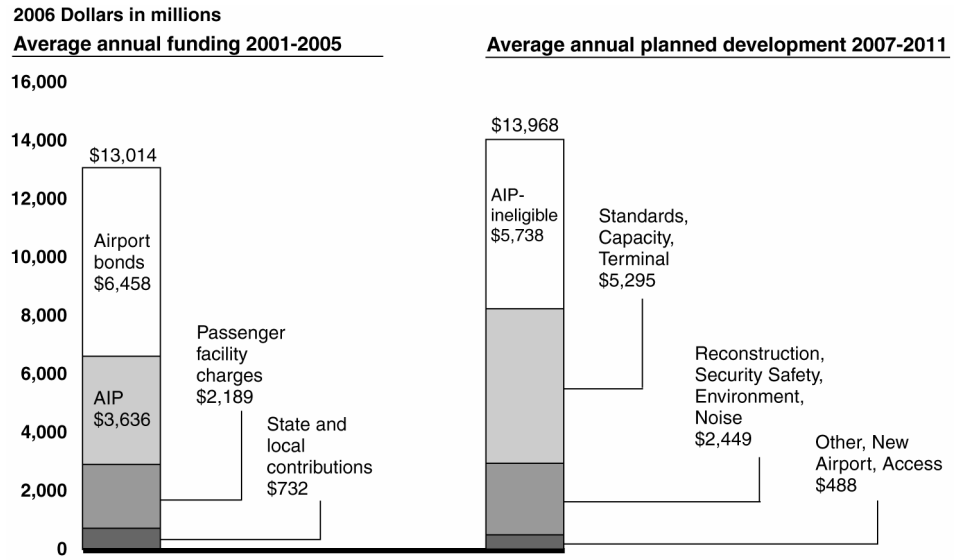
Sources: GAO analysis of FAA, ACI, Thomson Financial, and state grant data.

Note: Totals may not add up due to rounding

Total Planned Development Exceeds Past Funding Levels by About $1 Billion Annually

Based on past funding levels, airports' funding is about $1 billion per year less than estimated planned capital development costs. If the $13 billion annual average funding continues over the next 5 years and were applied only to AIP-eligible projects, it would cover all of the projects in FAA's estimate. However, much of the funding available to airports is for AIP-ineligible projects that can attract private bond financing. We could not determine how much of this financing is directed to AIP-eligible versus ineligible projects. Figure 2 compares the $13 billion average annual funding airports received from 2001 through 2005 (adjusted for inflation to 2006 dollars) with the $14 billion in annual planned development costs for 2007 through 2011. The $14 billion is the sum of FAA's estimated AIP-eligible costs of $8.2 billion annually and ACI's estimated ineligible costs of $5.8 billion annually. The overall difference of about $1 billion annually is not an absolute predictor of future funding shortfalls; both funding and planned development may change in the future.

Figure 2: Comparison of Historical Airport Funding to Future Development Costs



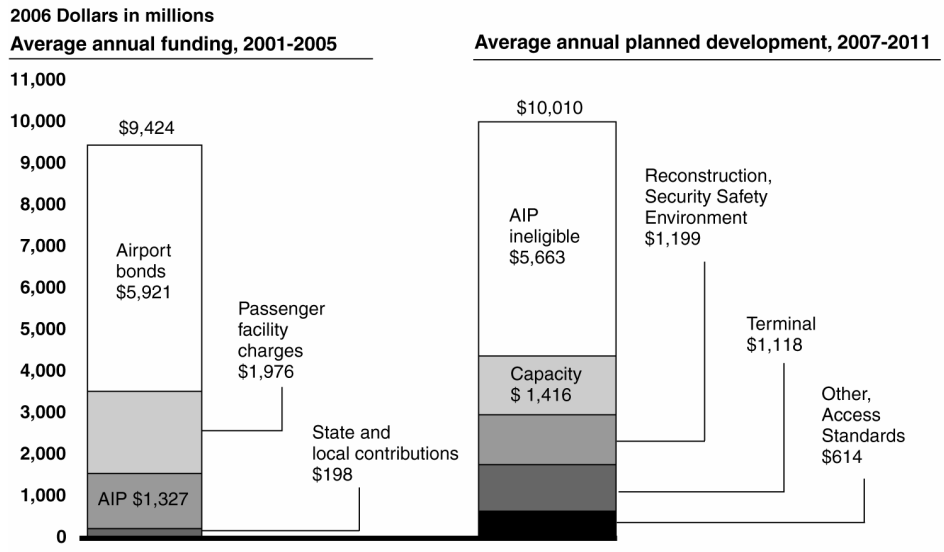
Sources: GAO analysis of FAA, ACI, Thomson Financial, and state grant data.

Note: Totals may not add up due to rounding

Larger Airports—Planned Development Costs Exceed Past Funding by About $600 Million Annually

The difference between current funding and planned development costs for larger airports is about $600 million if both AIP-eligible and ineligible projects are considered. From 2001 through 2005, larger airports collected an average of about $9.4 billion a year for capital development, as compared to over $10 billion in annual planned development costs. Figure 3 shows the comparison of average annual funding versus planned development costs for larger airports. At $5.7 billion annually, the ineligible portion of costs is 57 percent of the total planned development costs.

Figure 3: Comparison of Larger Airports' Historical Funding to Future Development Costs



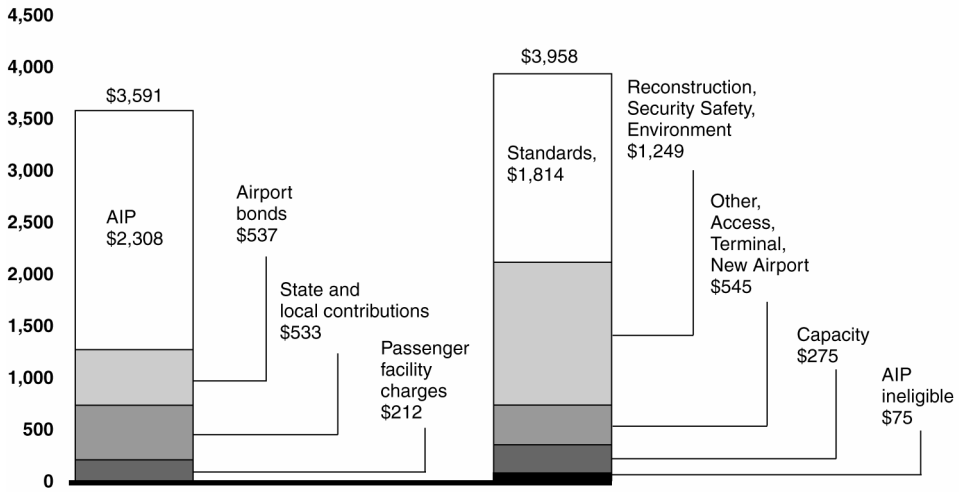
Sources: GAO analysis of FAA, ACI, Thomson Financial, and state grant data.

Note: Totals may not add up due to rounding

Smaller Airports—-Planned Development Costs Exceed Past Funding by About $400 Million Annually

The difference between past funding and planned development costs for smaller airports is roughly $400 million annually. At smaller airports, average annual funding from 2001 through 2005 was about $3.6 billion a year (expressed in 2006 dollars). Annual planned development costs for smaller airports from 2007 through 2011 is estimated at about $4 billion. Figure 4 compares average annual funding to planned development costs. As the figure shows, the portion of smaller airports' project costs not eligible for AIP funding is relatively small—about $75 million annually, or about 2 percent of total planned development costs.

Figure 4: Comparison of Smaller Airports' Historical Funding to Future Development Costs



Sources: GAO analysis of FAA, ACI, Thomson Financial, and state grant data.

Note: Totals may not add up due to rounding

Financial Health of Airports Has Improved for Larger Airports

The financial health of airports is strong and has generally improved since September 11, 2001, especially for larger airports. Passenger traffic has rebounded to 2000 levels and bond ratings have improved. Following September 11, many airports cut back on their costs and deferred capital projects. However, credit rating agencies and financial experts now agree that larger airports are generally financially strong and have ready access to capital markets. A good indicator of airports' financial strength is the number and scale of underlying bond ratings provided by bond rating agencies. More bonds were rated in 2007 than 2002, and more bonds are rated at the higher end of the rating scale in 2007, meaning that the rating agencies consider them less of a risk today. Furthermore, larger airports tended to have higher ratings than smaller airports.

Administration's FAA Reauthorization Proposal Would Increase Funding for Larger Airports, while the Effect on Smaller Airports is Uncertain

The administration's reauthorization proposal for AIP would increase funding for larger airports, but its effect on smaller airports is uncertain because of the overall reduction in AIP and the proposed changes in how AIP grants are allocated between larger and smaller airports. The 2008 fiscal year budget reduces AIP funding from its past level of $3.5 billion in fiscal years 2006 and 2007 to $2.75 billion in 2008. The proposal also would eliminate entitlement, otherwise known as apportionment, grants for larger airports while increasing the PFC ceiling from $4.50 to $6 per passenger.[6] While larger airports that account for 90 percent of all passengers will come out ahead, an increased PFC may not compensate smaller airports for the overall reduction in AIP, even with the proposed changes in how AIP is allocated between larger and smaller airports. As a separate issue, the administration's reauthorization proposal would change the way that AIP and other FAA programs are funded and may not provide enough monies for these programs, even at the reduced levels proposed by the administration.

Administration's FAA Reauthorization Proposal Would Make Fundamental Changes in AIP

The administration's 2008 FAA reauthorization proposal would reduce AIP, change how AIP is allocated, and increase the PFC available to commercial airports. (Key changes in the proposal's many elements are outlined in appendix I.) Unlike previous reauthorization proposals, which made relatively modest changes in the structure of the AIP program, this proposal contains some fundamental changes in the funding and structure of the AIP program. Notably, following the pattern set by the 2000 FAA reauthorization,[7] which required larger airports to return a certain percentage of their entitlement funding in exchange for an increase in the PFC, the administration proposes eliminating entitlement grants for larger airports altogether and at the same time allowing those airports to charge a higher PFC.

The reauthorization proposal would eliminate some set-aside programs and increase the proportion of discretionary grant funds available to FAA at higher AIP funding levels. Table 4 compares AIP funding allocations under the current funding formulas to the proposed reauthorization

[6]AIP grants generally consist of two types—(1) entitlement funds that are apportioned to airports or states by formula each year based on the number of airport passengers or state population and (2) discretionary funds that FAA approves based on a project's priority.

[7]The Wendell H. Ford Aviation Investment and Reform Act for the 21st Century, Pub. L. No. 106-81 (Apr. 5, 2000).

allocations at both the current $3.5 billion level and at the proposed $2.75 billion level. Another change is to the entitlement formulas—for example, removing the funding trigger in current law that doubles the amount of entitlement funds airports receive if the overall AIP funding level is above $3.2 billion—is intended to make more discretionary funding available. According to FAA officials, their objective is to increase the amount of discretionary funding for airports so that higher priority projects can be funded; however, that is only achieved when total AIP funds are greater than the $2.75 billion budgeted by the administration. For example, at $2.75 billion in AIP, the current law would generate $967 million in discretionary grants versus $866 million under the proposed reauthorization. This reverses at $3.5 billion in AIP funding, for which the proposal generates $1.328 billion in discretionary grants versus $845 million under current law.

Table 4: Estimated Distribution of AIP Funds at $2.75 and $3.5 Billion Funding Levels under Current and Proposed Authorization Formulas

Dollars in millions				
	AIP allocations under current law compared to proposed reauthorization			
	Current law	**FY2008 as proposed**	**Current law**	**FY2008 as proposed**
	$2.75 Billion		**$3.5 Billion**	
AIP funding (after administrative and other costs)	**$2,636**	**$2,636**	**$3,386**	**$3,386**
Entitlements				
Primary airports				
Large	92	81	$184	$92
Medium	56	49	111	56
Small	131	230	262	262
Nonhub	154	269	307	307
Subtotal primary airports	433	629	864	717
Cargo	92	81	118	118
Alaska supplemental	11	19	21	21
Nonprimary entitlements	0	309	385	431
State apportionment	488	300	292	339
Carryover entitlements	432	432	432	432

Dollars in millions

	AIP allocations under current law compared to proposed reauthorization			
	Current law	FY2008 as proposed	Current law	FY2008 as proposed
	$2.75 Billion		$3.5 Billion	
Subtotal entitlements	**1,455**	**1,769**	**2,113**	**2,058**
Small airport fund				
Nonhub commercial service	123		245	
Nonprimary airports	61		122	
Small hub	31		61	
Subtotal entitlements and nondiscretionary	**1,669**	**1,769**	**2,541**	**2,058**
Discretionary				
Noise set-aside	338	211	296	271
Reliever set-aside	0		6	
Military Airports (MAP) set-aside	39		34	
Subtotal disc set-asides	377	211	336	271
Small airport discretionary fund		136		266
Capacity, safety, security, noise	442	389	382	594
Remaining discretionary	147	130	127	198
Subtotal discretionary	**967**	**866**	**845**	**1,328**
Total AIP available for grants	**$2,636**	**$2,636**	**$3,386**	**$3,386**

Source: FAA

Increasing the PFC Would More Than Offset Loss of AIP Entitlements For Larger Airports but Impact on Smaller Airports Is Uncertain

The administration's proposed reauthorization would allow airports to increase their PFC to a maximum of $6 and allow airports to use their collections for any airport projects while forgoing their entitlement funds. A $6 PFC could generate an additional $1.1 billion for larger airports that currently have a PFC in place, far exceeding the $247 million in entitlements that FAA estimates they would forego under this reauthorization proposal (see table 5).[8] However, the impact on smaller airports is uncertain because they collect far less in PFCs and are more reliant on AIP for funding. A change to a $6 PFC would yield an additional $110 million for small hub airports based on airports that currently have a PFC in place and $132 million if every one of the small hub airports had a $6 PFC. It is uncertain whether the proposed allocation of AIP under the administration's proposal would shift a greater proportion of funds to smaller airports to compensate for the overall reduction in AIP. The reauthorization proposal would also relax project eligibility criteria to allow airports to use their collections in the same way as they use internally generated revenue, including off-airport intermodal transportation projects. The application and review process would also be streamlined; as a result, FAA would no longer approve collections but rather ensure compliance with PFC and airport revenue rules.

Table 5: Projected PFC Collections with a $6 PFC

Dollars in Billions					
		2005 Collections if $6 PFC			
	2005 Collections	Current incidence of PFCs	Increase over 2005 collections	If all airports had a $6 PFC	Increase over 2005 collections
Large hub	$1.769	$2.594	$.825	$2.695	$.925
Medium hub	.442	.725	.283	.781	.339
Subtotal	**2.211**	**3.319**	**1.108**	**3.476**	**1.265**
Small hub	.170	.281	.110	.302	.132
Total	**$2.381**	**$3.599**	**$1.218**	**$3.778**	**$1.397**

Source: GAO analysis of FAA data

[8]This calculation assumes that the increased PFC would not affect passenger demand for air travel. GAO has previously calculated that a PFC increase could reduce passenger demand. See *Passenger Facility Charges: Program Implementation and the Potential Effects of Proposed Changes*, GAO/RCED-99-138 (Washington D.C.: May 19, 1999).

Airport Privatization

The administration's proposal would modify the current pilot program on private ownership of airports in two key ways. First, the proposed modifications will expand eligibility beyond the current statutory limit of 5 to 15 airports. Restrictions limiting participation in the pilot program to specific airport size categories would also be eliminated. Second, the pilot program would be amended to eliminate the veto power that airlines can exercise under current law to prevent privatization transactions at commercial airports. Under current law, the sale of an airport to private interests may only proceed if a super-majority of the airlines at that airport approve of the sale or lease.[9] Additionally, the airline veto power to prevent fee increases higher than inflation rates would be repealed. In place of these veto powers, the airport sponsor would need to demonstrate to the Secretary of Transportation that the airlines using that airport were consulted prior to the transaction proceeding.[10]

Congress established the Airport Privatization Pilot Program in October 1996 to determine if privatization could produce alternative sources of capital for airport development and provide benefits such as improvements in customer service. It also hoped to determine if new investment and capital from the private sector could be attracted through innovative financial arrangements. Proponents of privatization believe that the privatization of airports can lead to capacity-increasing investment in airports through the commitment of private capital, lower operating costs, and greater efficiency and that privatization can increase customer satisfaction.

Overall, there has been relatively little interest in the current pilot program. Six airports have applied for participation in the program and three of those airports withdrew their applications in 2001. To date, Stewart International Airport, located in Newburgh, New York, is the only airport accepted into the pilot program. The airport received this exemption in March 2005, but is currently being purchased back by a public owner, the Port Authority of New York and New Jersey. In September 2006, the City of Chicago submitted a preliminary application for Chicago Midway International Airport. FAA completed its review of the Midway preliminary application and determined that it meets the

[9]The law defines super-majority as at least 65 percent of the scheduled air carriers at a primary airport.

[10]At non-primary airports, the exemption would continue to be based on consultation with at least 65% of the based-aircraft owners.

procedural requirements for participation in the pilot program. Consequently, the City of Chicago can now proceed to select a private operator, negotiate an agreement, and submit a final application to FAA for exemption.

Proposed Fuel Tax Rates May Not Yield the Revenue Anticipated to Fund AIP

In addition to concerns about the level and allocation of AIP funds, another concern is that the fuel tax revenues that the administration's reauthorization proposal has designated to largely fund AIP after 2009 may not be as great as anticipated. Currently, AIP and other FAA programs are principally funded by the Airport and Airway Trust Fund (trust fund), which receives revenue from passenger ticket taxes and segment taxes, airline and general aviation fuel taxes, and other taxes. The administration's reauthorization proposal would fund air traffic control through user fees for commercial aircraft and fuel taxes for general aviation while limiting the sources of revenue for the trust fund and its uses. Under the proposal, beginning in 2009, the trust fund would continue but only to fund three programs—AIP, Research, Engineering and Development (RE&D), and Essential Air Service (EAS)—and would be funded solely by an equal fuel tax on commercial and general aviation fuel purchases and an international arrival and departure tax.

FAA officials confirmed for us that in estimating fuel tax revenues they did not take into account possible reductions in fuel purchases due to the increase in the tax rates. Although we do not know by how much such purchases would decline, conventional economic reasoning, supported by the opinions of industry stakeholders, suggests that some decline would take place. Therefore, the tax rate should be set taking into consideration effects on use and the resulting impact on revenue. FAA officials told us that they believe that these effects would be small because the increased tax burden is a small share of aircraft operating costs and therefore there was no need to take its impact into account. Representatives of general aviation, however, have said that the impact could be more substantial. If consumption possibly falls short of projections or Congress appropriates more funds for AIP, RE&D, or EAS than currently proposed, then fuel tax rates and the international arrival and departure tax would correspondingly have to be increased or additional funding from another source, such as the trust fund's uncommitted balance or the General Fund, would be needed.

In conclusion, Mr. Chairman, airports have rebounded financially from the September 2001 terrorist attacks. We expect the demand for air travel to continue to increase, the system capacity to be stretched, and airports to

increase their demand for capital improvements to relieve congestion and improve their services. As Congress moves forward with reauthorizing FAA, it will have to decide on several key issues, including how it wants to fund and distribute grants under the AIP. While some elements of the administration's proposal are to be commended—for example, simplifying the funding formulas and giving FAA more discretion to fund high priority projects—other parts of the proposal raise concerns. For example, the extent to which the administration's proposed cuts in AIP funding will affect development at smaller airports is unclear.

GAO Contacts and Staff Acknowledgements

For further information on this statement, please contact Dr. Gerald Dillingham at (202) 512-2834 or DillinghamG@gao.gov. Individuals making key contributions to this testimony were Paul Aussendorf, Jay Cherlow, Jessica Evans, David Hooper, Nick Nadarski, Edward Laughlin, Minette Richardson, and Stan Stenersen.

Appendix I: Key Changes Proposed in AIP

Feature	Current authorization for AIP	Proposed AIP reauthorization
Funding	Trust fund for all capital programs are funded by an airline ticket tax, segment tax, international departure and arrival taxes, varying rates of fuel taxes and other taxes. Funding for AIP is appropriated from the trust fund.	Trust fund is funded by fuel tax of 13.6 cents/gallon for commercial and general aviation and a reduced international arrival and departure tax. Funding for AIP is appropriated from the Trust Fund. If AIP is increased, the tax rates would have to be increased, the trust fund's uncommitted balance would have to be drawn down, or another funding source would have to found.
Entitlements	Up to 75 percent of entitlements for large and medium hub airports collecting a PFC are turned back to the small airport fund.	Entitlements for large and medium hub airports eliminated by 2010.
	If AIP greater than $3.2 billion, primary airport entitlements are doubled.	$3.2 billion trigger for doubling entitlements is eliminated except for small and nonhub primary airports.
	State apportionment is 20 percent of AIP (18.5 percent if AIP is less than $3.2 billion).	State apportionment set at greater of 10 percent of AIP or $300 million.
	Nonprimary airport entitlement of up to $150,000.	The nonprimary airport minimum entitlement of $150,000 per airport is eliminated and replaced by a tiered system of entitlements ranging from $400,000 for large general aviation airports to $100,000 for smaller general aviation airports. The 750 airports that have less than 10 operational and registered based aircraft are guaranteed nothing.
Discretionary	Reliever and military airport set asides minimum discretionary funding set at $148 million.	The set-aside for reliever and military airports is eliminated.
	Small airport fund funded by large and medium hub airport PFC turnbacks of up to 75 percent of PFC collections.	Minimum discretionary funding set at $520 million.
		Small airport fund equal to 20 percent of discretionary funds.
Project eligibility	Most types of airfield projects, excluding interest costs, nonrevenue producing terminal space and on-airport access project costs. General aviation airports may use their entitlement funds for some revenue producing activities (e.g., hangars).	Expanded to include additional revenue producing aeronautical support facilities (e.g., self-service fuel pumps) at general aviation airports.

Feature	Current authorization for AIP	Proposed AIP reauthorization
Local government share of project cost (local match)	Government share set at 95 percent for smaller airports through 2007, and 75 percent for large and medium hub airports (noise 80 percent).	Eliminates 95 percent government share except for the very smallest airports. Now maximum share will be a flexible amount with a maximum percentage of 90 percent. Airfield rehabilitation projects lowered to 50 percent maximum at large and medium hubs.
PFCs	Maximum rate is $4.50 per passenger.	Maximum rate is $6 per passenger.
	All applications subject to FAA review.	Review and approval is streamlined.
	PFCs can be used for all AIP eligible projects, but also interest costs on airport bonds, terminal gates and related areas, and noise mitigation can also be used.	Eligibility expanded to include almost any airport –related project, including off-airport intermodal projects.
		Up to 10 large and medium hub airports willing to assume the cost of air navigation facilities are allowed a $7 PFC.
Privatization	Up to five airports, one of each size, with strict limit on rates and charges and requires approval by 65 percent of airlines.	Up to 15 airports of any size, no limit on rates and charges and no airline veto, but subject to DOT review and approval.

Source: GAO.

Appendix II: Scope and Methodology

To determine how much planned development would cost over the next 5 years, we obtained planned development data from the Federal Aviation Administration (FAA) and Airports Council International-North America (ACI). To determine how much airports of various sizes are spending on capital development and from which sources, we sought data on airports' capital funding because comprehensive airport spending data are limited and because, over time, funding and spending should roughly equate. We obtained capital funding data from the FAA, ACI, the National Association of State Aviation Officials (NASAO), and Thomson Financial—a firm that tracks all municipal bonds. We screened each of these databases for their accuracy to ensure that airports were correctly classified and compared funding streams across databases where possible. We did not, however, audit how the databases were compiled or test their overall accuracy, except in the case of state grant data from the NASAO and some of the Thomson Financial bond data, which we independently confirmed. We determined the data to be sufficiently reliable for our purposes. We subtotaled each funding stream by year and airport category and added other funding streams to determine the total funding. We met with FAA, bond rating agencies, bond underwriters, airport financial consultants, and airport and airline industry associations and discussed the data and our conclusions to verify their reasonableness and accuracy.

To determine whether current funding is sufficient to meet planned development for the 5-year period from 2007—2011 for each airport category and overall, we compared total funding to planned development. We correlated each funding stream to each airports' size, as measured by activity, and among other funding streams to better understand airports' varying reliance on them and the relationships among sources of finance. We then discussed our findings with FAA, bond rating agencies, bond underwriters, airport financial consultants, and airport and airline industry associations to determine how our findings compared with their knowledge and experiences.

To determine some of the potential effects from changes to how airport development is funded under the administration's proposed FAA reauthorization legislation, we first analyzed the suggested changes to the Airport Improvement Program's (AIP) funding and allocation. In particular we analyzed the effect of various funding levels on how the program funds would be allocated. Second, we evaluated the effects of raising the passenger facility charge (PFC) ceiling, as the administration proposal suggests, by estimating the potential PFC collections under a $6 PFC on the basis of 2005 enplanements and collection rates assuming all airports imposed a $6 PFC. Third, we determined the status of FAA's pilot program

for airport privatization. Moreover, we discussed the impact of all of the proposed changes (funding/allocation, $6 PFC, and privatization) with FAA, bond rating agencies, bond underwriters, airport financial consultants, and airport and airline industry associations.

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