



November 2014

AIRPORT PRIVATIZATION

Limited Interest despite FAA's Pilot Program

GAO Highlights

Highlights of [GAO-15-42](#), a report to congressional addressees

Why GAO Did This Study

Nearly all the 3,330 airports in the national airport system in the United States are publicly-owned and operated. However, some argue that the private sector could better fund and operate airports than public owners. GAO reported in 1996 that many barriers to full privatization existed in the United States. In 1996, Congress created the APPP which reduced some of the barriers to privatization. However, over the program's 18 years only two airports have privatized and one of them has reverted to public control.

To better understand airport privatization, GAO was asked and mandated to review several aspects of privatization. Specifically, this report describes (1) the experience with the APPP; (2) challenges airport owners and investors face to full airport privatization; (3) the potential effects of airport privatization; and, (4) reasons why airport privatization is more prevalent outside of the U.S. and stakeholder views on the APPP.

GAO reviewed airport application and docket information and interviewed applicants. GAO also interviewed 42 airport stakeholders including airports, airlines, airport consultants, labor groups, and private airport operators and financiers to gain their views on airport privatization in the U.S. and other countries. This non-generalizable group was mainly selected from our review of APPP docket documents and our prior work on airports.

DOT reviewed a draft of this report and provided technical comments which were incorporated as appropriate.

View [GAO-15-42](#). For more information, contact Gerald L. Dillingham, 202-512-2834 or dillinghamg@gao.gov

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What GAO Found

Since the FAA started to accept applications to the Airport Privatization Pilot Program (APPP) in 1997, 10 airports have applied to the pilot program (see figure). Of these 10, 2 were privatized, 7 did not complete the program, and one application is currently under FAA review. Public-sector airport owners' objectives for full privatization varied, but the overriding reason cited was financial benefit. The 7 applicants that withdrew did so for varied reasons, such as changes in market conditions that reduced expected privatization benefits.

Several factors reduce both public and private sector interest in airport privatization in the U.S.—such as higher financing costs for privatized airports and the possible lack of state and local property tax exemptions. Also, while the APPP reduces some of the challenges to privatization that we identified in 1996, privatization still requires considerable time and cost to navigate. Furthermore, public sector airport owners have found ways to gain some of the potential benefits of privatization without ceding control under full privatization, such as entering airport management contracts and joint development agreements for managing and building an airport terminal.

The potential effects of airport privatization on airport efficiency, the federal aviation trust fund, federal tax revenues, and airport employees and concessionaires are difficult to determine. Privatization's impact on these areas depends on many different factors such as how each airport privatization is structured, making it difficult to estimate the overall impact.

Different airport ownership and financing structures and motivations have driven more extensive overseas privatization efforts, as at least 450 airports around the world have been privatized to some degree. Stakeholders mentioned a variety of lessons learned from the U.S. and international experience, including ensuring public-sector due diligence, involving all stakeholders and creating a transparent privatization process. Stakeholders also provided a range of suggestions for modifying the APPP, from increasing the clarity of the program's rules to reducing the federal role in airport privatizations.

Airports That Have Applied to the Airport Privatization Pilot Program, 1997–2014



Source: GAO analysis of FAA data. | GAO-15-42

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Abbreviations List

ACRP	Airport Cooperative Research Program
AIP	Airport Improvement Program
APPP	Airport Privatization Pilot Program
BAA	British Airports Authority
CRS	Congressional Research Service
FAA	Federal Aviation Administration
ICAO	International Civil Aviation Organization
IRS	Internal Revenue Service
MidCo	Midway Investment and Development Company
NPIAS	National Plan of Integrated Airport Systems
NEG	National Express Group
NYDOT	New York Department of Transportation
PANYNJ	Port Authority of New York and New Jersey
PFC	Passenger Facility Charges
PRPA	Puerto Rico Ports Authority

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November 19, 2014

Congressional Addressees:

Most public-use airports in the United States have been publicly-owned, operated, and financed since commercial aviation service started in the 1920s.¹ Domestic interest in privatization has been sparked by (1) airport's estimated capital costs, projected to be an average of \$13.1 billion per year between 2013 and 2017; (2) the privatization of hundreds of airports around the world; and (3) the belief that private owners could operate airports more efficiently than public owners.² Others argue that airports already have extensive private sector participation through food and rental-car concessions or management contracts for whole airports. They also argue that the federal government has invested heavily in airports—about \$57.6 billion in grants from federal airline ticket taxes through the Airport Improvement Program (AIP) from 1993 through 2013 alone—investments which could potentially be turned over to the private sector without adequate compensation under privatization. We reported in 1996 that there were many legal and financial barriers to privatizing airports in the United States.³ In 1996, Congress created the Airport Privatization Pilot Program (APPP) to alleviate some of these barriers and test the potential for greater privatization.⁴ However, over the last 18 years since the APPP's inception, two airports were privatized under the pilot, and one of them has reverted to public sector control.

¹A public-use airport is defined as a public airport or a privately-owned airport used or intended to be used for public purposes that is a reliever airport; or determined by the Secretary to have at least 2,500 passenger boardings each year and to receive scheduled passenger aircraft service. 49 U.S.C. § 47102(22).

²We testified that FAA estimated Airport Improvement Program grants would average \$8.5 billion per year from 2013 to 2017 and that the Airports Council International-North America estimated that non-AIP eligible capital needs would be about \$4.6 billion for the same time period for a total estimated amount of \$13.1 billion. GAO, *Airport Funding: Aviation Industry Changes Affect Airport Development Costs and Financing*, [GAO-14-658T](#) (Washington, D.C.: June 18, 2014).

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

⁴Federal Aviation Reauthorization Act of 1996, Pub. L. No. 104-264, § 149, 110 Stat. 3213, 3224(1996).

To better understand airport privatization, particularly with respect to the APPP, you asked us and we were mandated to review several different aspects of privatization.⁵ Specifically, this report describes (1) the experience with the APPP since its inception; (2) challenges airport owners and investors face when seeking to privatize U.S. airports; (3) the potential effects of airport privatization; and, (4) reasons why airport privatization is more prevalent outside of the United States and stakeholder views on whether and how to revise the APPP.

To address these objectives, we analyzed the Federal Aviation Administration's (FAA) APPP documentation and public docket documents from 1997 to 2014 relating to each airport's application to the APPP. We conducted site visits to Chicago, Illinois and San Juan, Puerto Rico to interview FAA and local stakeholders about Chicago's Midway International Airport (Midway) and San Juan's Luis Munoz Marin International Airport (Luis Munoz Marin) APPP applications and processes and the potential and actual impacts of airport privatization. We selected these sites because they were the two of the largest airports in the APPP and because Midway went through a significant amount of the process but remained in public sector operation while Luis Munoz Marin went through the APPP process and did privatize. We reviewed industry and think-tank reports and interviewed 42 airport privatization stakeholders to obtain their views on the challenges of airport privatization in the U.S., the prevalence of airport privatization in other countries, and the potential impacts of airport privatization. These stakeholders included: FAA headquarters and regional officials; local public-sector airport owners; airlines; private-sector airport operators, consultants and investors; bond-rating agencies; airport labor groups; airport concessionaires, academic and other experts, and local public interest groups. We selected these stakeholders from our prior work on airports, from our review of APPP docket documents and their work on both U.S. and foreign airport privatizations. The results of our interviews with these stakeholders are not generalizable. For more details on our objectives, scope and methodology, see appendix I.

We conducted this performance audit from January 2014 to November 2014 in accordance with generally accepted government auditing

⁵S.Rep. No. 113-45, at 40, accompanying the Senate Committee on Appropriations, Transportation and Housing and Urban Development, and Related Agencies Appropriations Bill, 2014, S. 1243.

standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Nearly all of the 3,330 commercial service or general aviation airports designated as part of the national airport system are under city, state, county or public-authority ownership.⁶ Airport ownership in the United States has evolved under a public model since the 1920s as a way to promote the development of the U.S. aviation industry. The Surplus Property Act of 1944 transferred excess military bases and property to state and local governments for use as public airports and was a contributing factor to the development of airports as a public asset.⁷

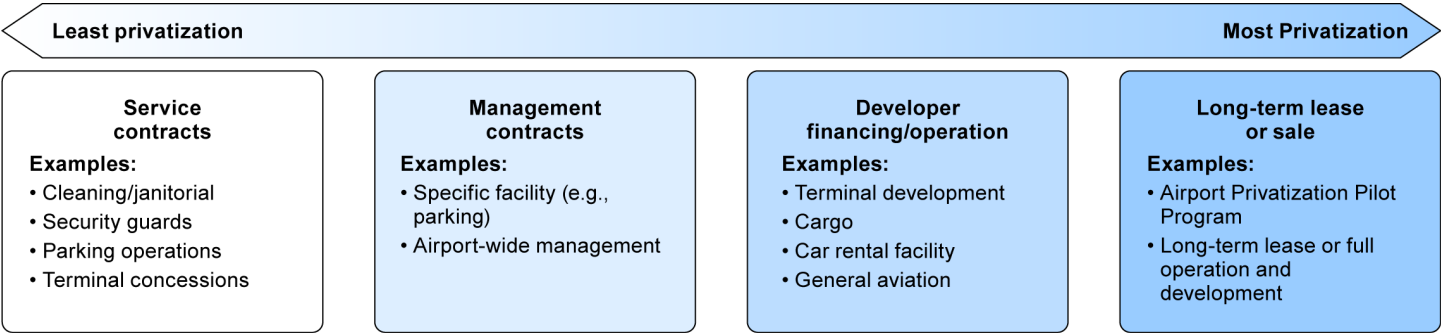
Privatization generally refers to shifting governmental functions and responsibilities to the private sector. FAA more specifically has defined airport privatization as transferring airport operations from the public sector to the private sector through a formalized transfer of federal grant obligations and the granting of a Part 139 operating certificate to the new

⁶The National Plan of Integrated Airport Systems (NPIAS) identifies these 3,330 airports as those significant to national air transportation and therefore eligible to receive grants under the FAA's Airport Improvement Program (AIP). Commercial service airports are publicly-owned airports that have at least 2,500 passenger boardings each calendar year and receive scheduled passenger service (49 U.S.C. 47102(7)). There are some exceptions to the broad generalization of public ownership. For example, general aviation airports, the largest category of airports, are generally defined as airports that do not fit any other FAA classification and include privately-owned, public-use airports with at least 2,500 passenger boardings each year. In addition, the federal government owns two primary hub airports, Washington-Reagan National Airport and Washington Dulles International Airport, which are operated under a long-term lease arrangement with the Metropolitan Washington Airports Authority. The Department of Defense also owns parts of joint-use airports where the airfield facilities are shared between military and civilian use. FAA, *Report to Congress, National Plan of Integrated Airport Systems (NPIAS), 2013-2017* (Washington, D.C.: Sept. 27, 2012).

⁷Ch. 479, § 13(g)(1), 58 Stat. 770. In the 1940s the federal government created the first federal grant program to the public sector for capital development for airports with the creation of the Federal Aid Airport Program, which drew funding from the U.S. Treasury (Federal Airport Act of 1946, c. 251, 60 Stat. 170(1946)).

airport operator.⁸ However, private sector involvement in airports can and does take many forms not necessarily requiring the transfer of ownership control of the airport. A 2012 Airport Cooperative Research Program (ACRP) report on airport privatization, for example, identifies the general forms of airport privatization, ranging from the least amount of private sector activity (service contracts) to full privatization (sale or lease of airport in its entirety) as outlined in figure 1 below.⁹

Figure 1: Extent of Privatization at Airports in the United States



Source: GAO analysis of ACRP information. | GAO-15-42

At one end of the privatization continuum, nearly all domestic airports rely on services contracts for janitorial services, parking operations, or terminal concessions, which are leases with private vendors acting as tenants. Next in the continuum are management contracts for airport operations, where airport owners contract out management of either specific operations (like the management and operation of parking facilities or terminal operations) or contract out the entire airport to a private sector entity. As an example of the latter, AvPorts Management LLC, a private sector airport operating company, manages Albany

⁸The Part 139 certificate is an airport-operating certificate that ensures safety in air transportation (14 C.F.R. Part 139). Airport owners must apply for the certificate and are assessed by a Part 139 inspection administered by FAA. Any airport in the United States and related areas serving passenger-carrying operations must have a Part 139 certificate if scheduled passenger-carrying operations are conducted on aircraft with more than nine passenger seats or unscheduled passenger-carrying operations are conducted on aircraft with at least 31 seats (14 C.F.R. § 139.1(a)(1) and (2)).

⁹Airport Cooperative Research Program, Report 66: *Considering and Evaluating Airport Privatization* (Washington, D.C.: May 29, 2012).

International Airport and is responsible for airport management, operations, maintenance, airport rescue and fire, parking lot operations, shuttle bus operations, and operation and management of aircraft deicing collection and treatment systems. Next are private developers, financiers, and operators, who provide capital investment for airport development. In this scenario, private investors finance the development of a terminal or facility and may be responsible for its operations and maintenance in return for a share of the revenues. One example is at Terminal 4 of the Port Authority of New York and New Jersey's (PANYNJ) John F. Kennedy International Airport where the private sector developed and manages the terminal, but PANYNJ maintains overall operations of the airport. At the most privatized end of the continuum is the sale or long-term lease of the entire airport asset to a private sector operator. Of the 501 commercial service airports in the United States, private sector operators hold Part 139 airport operating certificates for only 2—Luis Munoz Marin, which is under a 40-year lease, and Branson Airport in Missouri, which was privately developed.¹⁰ Currently, a private-sector airport operator holds the FAA Part 139 airport operating certificate for only 1 of the 3,330 airports that the FAA has designated for inclusion in the NPIAS, at Luis Munoz Marin.

In the United States, airport capital investments are generally funded through a combination of federal Airport Improvement Program (AIP) grants, federally-authorized Passenger Facility Charges (PFC), and locally generated aeronautical and non-aeronautical revenues.¹¹ For larger capital projects, airports often issue bonds, backed either by these revenue streams or by the general taxing authority of the public-sector airport owner.

- AIP grants: FAA provides both apportionment and discretionary grants to airports, which have averaged in total a little over \$3 billion

¹⁰Number of boardings determines airport size. For the largest 400 commercial service airports in calendar year 2013, annual boardings range from about 45 million at Hartsfield-Jackson Atlanta International Airport in Atlanta, Georgia to about 2,500 boardings at Atmautluak, Alaska.

¹¹AIP grants, U.S.C. § 47104; PFC charges 49 U.S.C. § 40117.

annually.¹² All airports in the NPIAS are eligible to receive apportionment grants, which are determined on an annual basis for primary airports by a formula based on the number of passengers and amount of cargo carried. For non-primary airports, the funding formula is based on the development needs at those airports as identified in the NPIAS, with a minimum apportionment grant of \$150,000.¹³ These airports may also compete for AIP discretionary grants, which fund national priorities and objectives that enhance capacity, safety, or environmental concerns. Grants require a local match of 5 to 30 percent depending on airport size or type of project.¹⁴

- PFC charges: The PFC program authorizes participating airports to collect up to \$4.50 per boarded passenger, per flight segment.¹⁵ Airports apply for participation in the program, and if approved, funds collected by airlines through fees placed on passenger tickets are remitted to airports to use for FAA-approved development projects that preserve or enhance airports' safety, security, or capacity; reduce noise; or enhance airline competition.¹⁶ Additionally, PFCs can also be used to pay interest costs on debt issued for FAA-approved airport development projects.¹⁷ According to FAA, 388 commercial service airports were approved to collect PFCs as of April 2014.¹⁸ Annual PFC collections totaled about \$2.8 billion in calendar year 2013, with

¹²Apportionment grants, 49 U.S.C. § 47114; discretionary grants, 49 U.S.C. § 47115. AIP grants are supported by the Airport and Airway Trust fund, which is funded in part by airline taxes and fees (26 U.S.C. § 9502). At the beginning of fiscal year 2014, the trust fund had a cash balance of \$13.2 billion. AIP appropriations totaled about \$3 billion in fiscal year 2013, with a breakdown of 53 percent awarded as apportionment grant funds and 47 percent awarded as a hybrid of apportionment and discretionary grant funds.

¹³The annual apportionment can be accumulated for up to four years and can be supplemented by the FAA with state apportionment funds.

¹⁴49 U.S.C. § 47109.

¹⁵49 U.S.C. § 40117.

¹⁶The Secretary of Transportation approves PFC applications for amounts greater than \$3 per boarding passenger if the airport has more than .25 percent of the total number of annual boardings in the United States, the project is an airport-related project, and the application includes adequate justification for each project, and for large and medium hub airports, if adequate provisions for financing airside needs of the airport have been made. (49 U.S.C. §40117).

¹⁷49 U.S.C. 40117(b)(1).

¹⁸[GAO-14-658T](#).

the most collections going to large and medium hub airports, proportionate to their number of passenger boardings.

- Locally generated revenues: Aeronautical revenue is generated from airlines and general aviation users of the airfield or terminal and includes charges for aircraft-landing fees and terminal rentals. While the FAA ensures that airport rates and charges to airlines are reasonable, as required by federal law, through its grant agreements with airport owners, it does not set those rates.¹⁹ Non-aeronautical revenue includes rents the public owner collects from restaurant and retail concessionaires, rental car concessions, and parking-garage fees. These revenue streams are used as repayment of bond debt issued to finance various airport capital-improvement projects including both new and rehabilitated facilities. We have reported that on average about 55 percent of airport revenues come from aeronautical charges and 45 percent come from non-aeronautical charges.²⁰

Our last report on airport privatization in 1996 found that the full privatization of airports in the United States was unlikely due to a myriad of legal and financial barriers. Most significantly, airports that received AIP grants were subject to grant obligations that preclude any airport revenue for non-airport purposes by the public-sector airport owner (revenue diversion).²¹ As a result, if such an airport were to be fully privatized, then the public-sector owner could not use any of the proceeds from the lease or sale of the airport for any purpose other than reinvesting in the airport (or any other airport owned by the public sector entity); nor could the private sector operator or owner retain profits earned from the privatized airport. Another barrier we identified was private airport owners' ineligibility to collect PFC's or receive AIP grants.²² In addition, the public-sector owner of an airport that was privatized could have been

¹⁹ 49 U.S.C. 47107.

²⁰ [GAO-14-658T](#).

²¹ 49 U.S.C. § 47107(l). Airport revenue refers to revenues paid to or due to the airport sponsor for use of airport property by both aeronautical and non-aeronautical users of the airport such as fees, charges, rents or other payments. It also includes revenue from sale of the airport property and resources and revenue from state and local tax on aviation fuel. *FAA Airport Compliance Manual – Order 5190.6B Chapter 15*.

²² 49 U.S.C. §§ 40117 and 47114.

required to repay federal grants or return surplus federal property at that airport. Finally, unlike public airports, privatized airports would not be able to obtain access to tax exempt debt.²³

The Federal Aviation Reauthorization Act of 1996 alleviated some of the challenges mentioned above by establishing the Airport Privatization Pilot Program (APPP).²⁴ Under the APPP, commercial service airports can be leased while general aviation airports can be sold or leased subject to certain conditions.²⁵ The sale or lease proceeds can also be used for non-airport purposes if at least 65 percent of the air carriers serving the airport approve.²⁶ The APPP enables commercial service and general aviation airports that are privatized under the APPP to continue to collect PFCs and receive AIP grants.²⁷ Airports can also continue to collect AIP discretionary grants, although their match would increase to 30 percent.²⁸ Finally, the Secretary of Transportation (Secretary) can waive: repayment of federal grants; the requirement to use airport revenues for non-airport purposes, and; the required return of federal property if the Secretary determines that public investments previously made in airports are protected and airports continue to be available for public use.²⁹ The 1996 FAA Reauthorization Act allowed five airports to participate and mandated that only one participating airport could be a large hub and that

²³However, a public entity could issue tax-exempt Private Activity Bonds for improvements to a privatized airport.

²⁴The Federal Aviation Reauthorization Act of 1996, Pub. L. No. 104-264, § 149, 110 Stat. 3213, 3224(1996). APPP, codified at 49 U.S.C. § 47134.

²⁵49 U.S.C. § 47134(a). A long-term lease under the APPP would shift control of the asset to the private owner since the new owner would hold the Part 139 operating certificate. For tax and regulatory purposes, a long-term lease is equivalent to ownership through a sale of the asset.

²⁶49 U.S.C. § 47134(b)(1)(A). According to the APPP, this percentage is measured by each air carriers' percentage of the total amount of aircraft weight landed at that airport in the preceding year. Foreign air carriers and air carriers that no longer serve the airport are not included in this calculation.

²⁷49 U.S.C. § 47134(g).

²⁸Match requirements for public airports can range from 10 percent for small primary, reliever, and general aviation airports to 25 percent for large and medium primary-hub airports. There is also a 30 percent match requirement for airports under the APPP program. 49 U.S.C § 47109 (a) (4).

²⁹49 U.S.C. § 47134(b)(2).

at least one participant had to be a general aviation airport.³⁰ The FAA Modernization and Reform Act of 2012 increased the number of potential participants to 10.³¹

Under the APPP, the current public-sector airport owner is responsible for overseeing the privatization process by satisfying all legal requirements and selecting the private bidder.³² To initiate the APPP process, public-sector airport owners can submit to FAA for approval either a preliminary application without a private operator selected or a final application that identifies a selected private operator. FAA is to review the application, provide comments, and if approved, award the public owner a slot in the privatization program. If the public-sector airport owner submitted a preliminary application, a confirmed slot in the program means the applicant can select a private operator, negotiate lease terms, and submit a final application for FAA approval. Once the final application is accepted, FAA is to provide notice for a 60-day public comment period, hold a public meeting towards the end of this period, and respond to comments received. This process is outlined in figure 2 below.

Figure 2: Airport Privatization Pilot Program Application Process



Source: GAO analysis of FAA information. | GAO-15-42

³⁰Pub.L.No. 104-264, §149(a)(1), 110 Stat. 3213, 3224(1996).

³¹Pub. L. No. 112-95, § 156, 126 Stat. 11, 36 (2012).

³²The APPP does not require the public-sector airport owner to seek competitive bids or to follow any specific procurement process for selecting a private-sector airport operator.

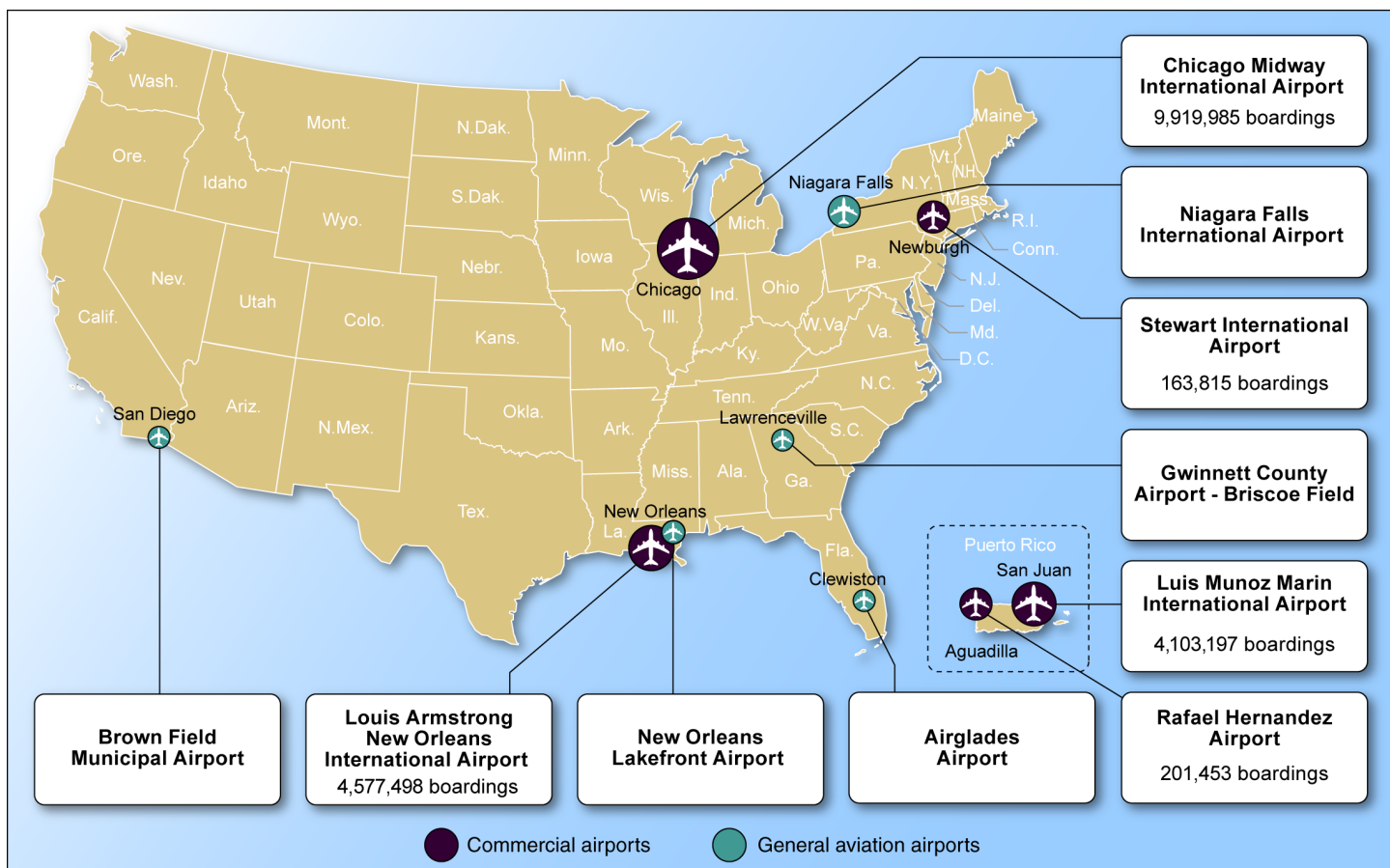
The Airport Privatization Pilot Program Has Resulted in Few Privatizations

Airports That Participated in APPP Sought Financial or Economic Benefits

Since the FAA started accepting applications in 1997, 10 airports (5 commercial service and 5 general aviation or general aviation reliever airports) have applied to the pilot program. Those 10 airports are identified in figure 3. Public-sector airport owners' objectives for full privatization varied; however, the overriding reason for privatization for nearly all applicants was to gain some financial benefit. Nine of 10 applicants indicated that obtaining either a financial return from leasing or selling the airport or economic development benefits for the local community were objectives for transfer of airport control under the APPP. These financial returns could include an up-front lease payment or on-going payments from the private-sector airport operator over the life of the lease, or a combination of both types of payments.³³

³³Another possible financial return that the public-sector airport owner could obtain could be the sharing of any gains from refinancing any debts taken by the private-sector airport operator. As there are no federal requirements in the APPP on sharing refinancing gains, such a provision would have to be included in the use agreement between the public-sector airport owner and the private-sector airport operator. No U.S. airport privatization agreement has included such a provision. We have reported that toll-road privatizations in the UK and in Australia had provisions that any gains from refinancing by concessionaires that are not already factored into the calculation of tolls be shared equally with the government. GAO, *Highway Public-Private Partnerships: More Rigorous Up-Front Analysis Could Better Secure Potential Benefits and Protect the Public Interest*, [GAO-08-44](#) (Washington, D.C.: Feb. 8, 2008).

Figure 3: APPP Applicant Airports, 1997–2014



Source: GAO analysis of FAA data. | GAO-15-42

Notes: Boardings shown are for calendar year 2013. General aviation airports generally do not have scheduled commercial service and have less than 2,500 boardings a year. Niagara Falls International Airport was classified as a joint-use military and general aviation reliever airport at the time it was in the APPP. The airport is now classified as a commercial service airport and had 99,958 boardings in calendar year 2013.

Larger commercial service airport sponsors sought full privatization through the APPP to use lease proceeds for non-airport purposes and to improve operations. The City of Chicago, for example, sought to obtain proceeds from a long-term lease of Midway to help meet the city's \$9 billion unfunded pension liability. After securing state legislation to extend the airport's exemption from property taxes to a potential private-sector

airport operator, among other things, the City committed to using the net proceeds from privatization for airport infrastructure projects or to fund city pensions.³⁴ According to the Puerto Rico Ports Authority (PRPA), the public-sector owner of Luis Munoz Marin (as well as the operator of several other aviation facilities and the owner or operator of several non-aviation facilities), PRPA needed immediate debt relief, improved airport operations, and substantial infrastructure improvements for the airport. Notably, when the PRPA applied to privatize Luis Munoz Marin in 2009, the Authority carried more than \$800 million of debt and wanted to apply the proceeds from the long-term lease of the airport towards reducing that debt.³⁵ The governor of New York at the time of Stewart International Airport's (Stewart) privatization identified the goals of privatization as providing the Hudson Valley region with better air service, increased economic development, and a strengthened tax base as main objectives for full privatization. The governor wanted to use the expertise of the private sector to develop the underutilized airport and surrounding real estate, which it hoped would result in more jobs and economic development for the region.³⁶

Under the APPP, commercial service airports can only be leased. The financial structure of these privatizations included an upfront payment followed by a stream of payments over the lease term. The private sector bidders have proposed to finance their purchases through a mix of debt and equity. For example, in the case of Luis Munoz Marin, Aerostar, the private-sector airport operator that won the lease of the airport, financed \$350 million of the \$615 million up-front payment by issuing bonds with a maturity of 22 years and yield of 5.75 percent. The investment was supplemented with \$265 million in equity financing. One private-sector airport operator that we spoke with stated that the expected return on invested equity that private equity owners generally demand ranges between 10 and 20 percent, which is a higher return on equity than debt because it is unsecured and returns are more uncertain. Table 1 outlines the purchase and financing structure that include up-front equity and debt issuance for the three applicants that submitted final APPP applications to the FAA including the two completed privatizations (Stewart and Luis

³⁴ACRP, Report 66: *Considering and Evaluating Airport Privatization*.

³⁵ACRP, Report 66: *Considering and Evaluating Airport Privatization*.

³⁶ACRP, Report 66: *Considering and Evaluating Airport Privatization*.

Munoz Marin), and the first privatization attempt for Midway. For the lease of Stewart, the bidder, National Express Group (NEG) relied on NEG equity funds and revolving credit for its \$35 million up-front lease payment in 2000. In the final application for Midway's first effort, Midway Investment and Development Company (MidCo) stated that at least 20 percent of the initial upfront payment would come from equity with the rest made up from loans and additional equity. MidCo's financial plan for the first Midway privatization effort depended on an estimated over \$1.12 billion (in nominal dollars) increase in PFC collection authority to cover the additional costs of refinancing MidCo's outstanding debt, which would have been about a 45 percent increase over Midway's approved estimated amount of \$2.5 billion in PFC collection authority for the same number of planned capital projects. To close the lease for Luis Munoz Marin, FAA required the PRPA to confirm the investor's ability to finance the initial lease amount and perform over the lease term. FAA officials stated that they ensured that the new private operator could secure its financing.

Table 1: Financial Structure for the Lease Payment and Financing of Selected U.S. Airports That Submitted a Final Application to the APPP

Year	Airport sponsor	Airport	Up-front lease payment	Financing structure
2000	New York State Department of Transportation	Stewart	\$35 million	Funds from private sector operator and revolving credit ^a
2008 (proposed)	City of Chicago	Midway	\$2.521 billion	\$500 million to \$1 billion in equity (20 to 40 percent), remainder from either additional equity or loans (80 to 60 percent) ^b
2013	Puerto Rico Ports Authority	Luis Munoz Marin	\$615 million	\$350 million from debt financing of investment grade bonds (57 percent), \$265 million from equity (43 percent)

Source: GAO Summary of FAA Docket Information|GAO-15-42

^aInformation regarding distribution of debt and equity not available.
^bThese numbers reflect the financing structure for the first privatization effort for Midway. MidCo's proposed increase in PFC authority would have helped to cover the additional costs of re-financing its outstanding debt.

In contrast to large commercial service airports, smaller general aviation airports applied to the APPP as a means to attract capital improvements to expand airport operations and to increase or attract commercial service. For example, Niagara Frontier Transportation Authority's

objectives for Niagara Falls International Airport were to develop the airport's seasonal charter service and foster regional service to major airport hubs.³⁷ The Gwinnett County Board of Commissioners (Gwinnett County Airport—Briscoe Field) and the Board of Commissioners for the Orleans Levee District (New Orleans Lakefront Airport) both sought proceeds for the redevelopment of airport infrastructure to create more options for commercial passenger service or increase the quality and value of services for airport users in their respective locations, while Airglades Airport in Hendry County, Florida, is seeking to make improvements to initiate air cargo service at the airport.

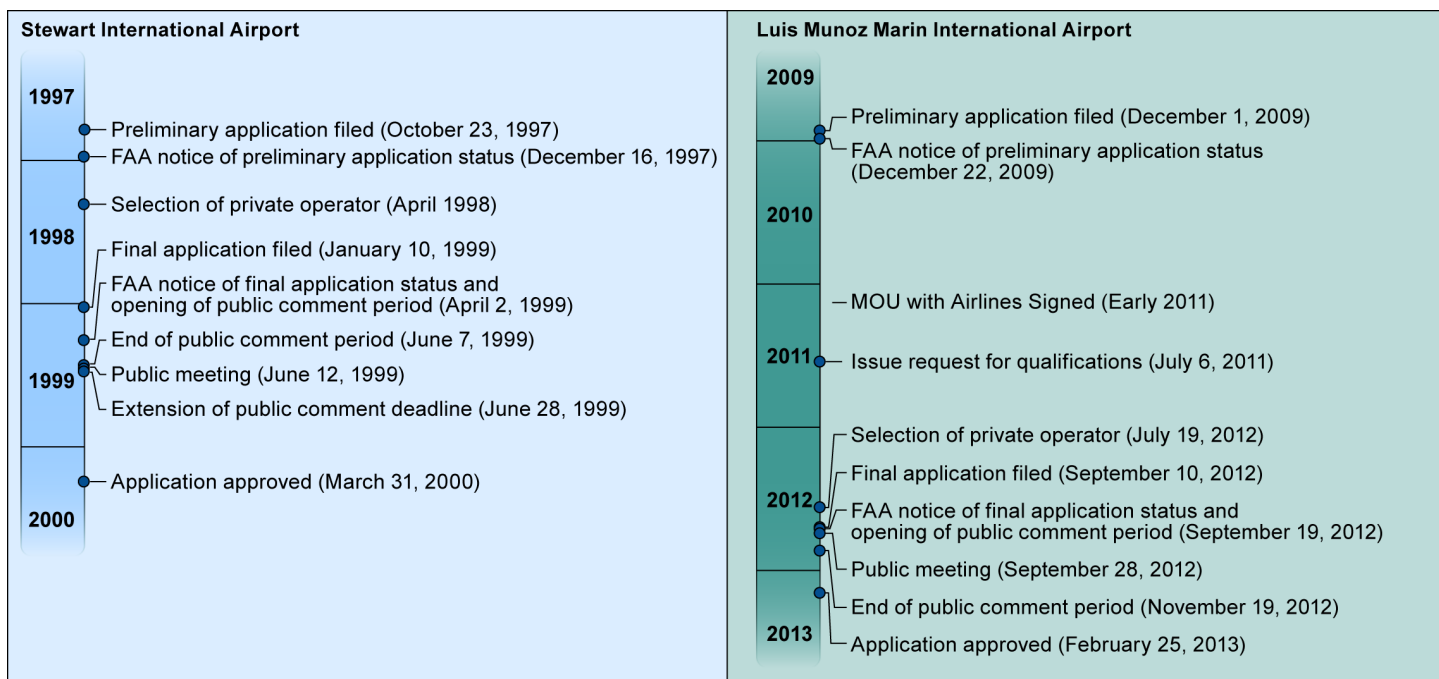
Two Airports Have Been Privatized under the APPP; One Application Is Active, and Seven Airports Left the Program for Various Reasons

Since the FAA started accepting applications for the APPP in 1997, two airports have been privatized under the APPP: Stewart and Luis Munoz Marin (see fig. 4). These privatizations took from about 2.5 to more than 3 years from the initial application to completion. Stewart was privatized in 2000 with a 99-year lease agreement but reverted back to public control in 2007, leaving Luis Munoz Marin as the only remaining privatized airport under the APPP. Additionally, there is one active application currently in the APPP for Airglades Airport in Hendry County, Florida.³⁸ In August of 2014, FAA approved a management contract between Hendry County and Airglades International Airport LLC pending Hendry County's submission of the final APPP application.

³⁷FAA, *Report to Congress on the Status of the Airport Privatization Pilot Program* (Washington, D.C.: August 2004).

³⁸FAA is currently reviewing the environmental assessment that was submitted as part of the proposed privatization of this airport. The assessment is focused on the proposed new 10,000-foot runway that the private sector airport operator wants to build to ensure that the proposed airport expansion and transfer to the private operator would not adversely affect the surrounding environment. Federal law requires FAA to review proposed changes to airport layout plans (as well as AIP and PFC funding decisions among other federal actions) to ensure they are in accordance with the National Environmental Policy Act, which requires federal agencies to analyze and publicly disclose the purpose and need for a project, feasible alternatives, nature and extent of a project's environmental effects and proposed mitigation measures.

Figure 4: Airport Privatization Pilot Program for Stewart (1997-2000) and Luis Munoz Marin (2009-2013)



Source: GAO summary of applicant information. | GAO-15-42

- Stewart was the first commercial service airport to participate in the APPP, submitting its preliminary application in October 1997. The application process took about 2.5 years and concluded in March 2000 with the finalization of the lease to NEG. The state of New York, the public owner of Stewart and other airports in the state, was unable to attain air carrier approval to use proceeds from the long-term lease for non-airport use so it invested the \$35 million up-front lease payment and future lease payments in other state-owned airports.³⁹ Shortly before assuming the lease, NEG tried unsuccessfully to terminate its lease obligations because of a shift in its business focus. NEG was unable to sell the lease to another party because the lease prohibited doing so for a minimum of 5 years. As a result, according to the recent ACRP report on airport privatization, NEG focused on

³⁹The New York Department of Transportation (NYSDOT) allocated \$2.5 million for continued operation and development of Republic Airport in Farmingdale, NY, which is owned and operated by NYSDOT.

managing the airport for immediate financial return and was not interested in investing in the airport.⁴⁰ In October 2007, NEG sold the remaining portion of the 99-year lease to the PANYNJ for \$78.5 million, putting the airport under public sector management once again. The PANYNJ later contracted management of the airport to AvPorts; however, PANYNJ still holds the airport's Part 139 certificate.

- Luis Munoz Marin was privatized in 2013 after a little more than 3 years in the APPP. Public stakeholders included the public airport owner (PRPA), the Puerto Rico Public-Private Partnership Authority, and the Puerto Rico Government Development Bank. A study prepared by the Puerto Rico Public-Private Partnerships Authority and PRPA determined that privatization should increase airport capital investments, revenue generation, and cost controls while also minimizing risk to the public sector through protection of the public sector interests.⁴¹ The study noted that the airport's performance lagged behind other Caribbean counterparts in total passenger growth, boardings had decreased, aviation operational financial performance had been flat over the past 3 years, and the credit profile of PRPA had been scrutinized by Moody's and S&P. These factors, according to the study, contributed to the desirability of privatization. Aerostar paid \$615 million up-front to PRPA and will pay an additional estimated \$600 million through revenue sharing over the 40-year term of the lease.

Seven applicants to the APPP left the program before the airport was privatized.⁴² Niagara Frontier Transportation Authority (Niagara Falls International Airport) withdrew after failing to re-submit its final application in response to FAA's concerns that the application and lease did not comply with the intent and some specific requirements of the APPP. The Orleans Levee District's application for New Orleans Lakefront Airport was terminated due to a shift in sponsorship of the airport property

⁴⁰ACRP, Report 66: *Considering and Evaluating Airport Privatization*. In addition, according to one private sector airport consultant we interviewed who was familiar with Stewart Airport's privatization, NEG applied for AIP funding and made capital improvements up to the amount awarded for the grants.

⁴¹Puerto Rico Public-Private Partnership Authority, *Study of Desirability and Convenience for Luis Munoz Marin International Airport*, (San Juan, Puerto Rico: June 2010).

⁴²Six applicants withdrew from the APPP and one application was dismissed by the FAA due to a change in legal status to continue the privatization process.

removing the District's ability to sell the airport. PRPA withdrew its application for Rafael Hernandez Airport and instead decided to develop the airport without a private operator.⁴³ Four of the seven withdrew their applications due to reduced financial stability of the proposed private sector owner/operator or other financial concerns. For example, the City of Chicago withdrew Midway's final application for its first privatization effort after it was submitted to the FAA for approval because the selected private-sector operating consortium could not complete its financing plan. The New Orleans Aviation Board withdrew Louis Armstrong International's preliminary application after analysis of market conditions indicated that New Orleans was not well-positioned to solicit bids for the program. Along with financial concerns, community opposition or a shift in political support have also played a role in decisions to withdraw. Privatization efforts for both Brown Field Municipal Airport and Gwinnett County Airport Briscoe Field faced community opposition due to air traffic and financial and economic concerns respectively that shifted political support against privatization. Officials for Gwinnett County, the public sector owners of Briscoe Field, were concerned with, among other things, financial risks associated with a potential default of the private investor, commitment to contracts and leases without expressed interest from airline carriers, and the financial burden placed on the public sector to complete the proposed infrastructure improvements.⁴⁴

Privatization outside the APPP Is Also Rare

Private ownership or operation of domestic commercial service airports outside of the APPP is also rare. Only one commercial service airport in the United States was privately developed and is privately operated—Branson Airport in Branson, Missouri. Branson Airport's operator, Branson Airport LLC, chose not to participate in the APPP and developed the airport with financing from \$60 million in private investment and \$114 million in tax-exempt bonds.⁴⁵ The Branson Regional Airport Transportation Development District issued the tax-exempt bonds as Private Activity Bonds. Building this new airport took 22 months, with

⁴³According to FAA, the Puerto Rican government changed administrations following elections and the newly-elected administration chose not to proceed with this privatization.

⁴⁴Infrastructure improvements could include development of roads, specialized fire or emergency facilities, and acquiring security and police facilities and personnel.

⁴⁵Under Section 103 of the Internal Revenue Code, interest earned on most bonds issued by state and local governments is tax-exempt meaning that the interest paid to bondholders is generally not included in their gross income for federal income tax purposes.

construction beginning in 2007. Although privately developed and operated, Branson Airport LLC holds a long-term lease agreement with Taney County, MO, for the airport land and the airport collects \$8.24 from the City of Branson for every passenger that flies into Branson Airport, to support tourism in Branson and the surrounding area. Branson Airport LLC chose not to participate in the AIP program because taking AIP grants would subject them to grant obligations—among them economic nondiscrimination requirements. Without these obligations, Branson Airport LLC has the flexibility to optimize returns and can negotiate different landing charges with different airlines that serve the airport. However, passengers that fly to or from Branson Airport still pay federal ticket taxes into the Airport and Airway Trust Fund which funds AIP grants, even though Branson Airport LLC has not chosen to receive any AIP grants. Branson Airport, like any airport, is also susceptible to shifts in passenger traffic. While a Branson Airport LLC representative stated that the airport has had 1.1 million passengers in its first 5 years of operation, in recent years, passenger traffic at Branson has declined and Branson Airport LLC has entered into a forbearance and funding agreement with the bondholders' trustee.

FAA Assists in the Application Process but Does Not Promote Airport Sponsor's Participation in the APPP

FAA administers the APPP program but does not actively seek applicants.⁴⁶ FAA reviews applications, provides guidance and technical assistance, facilitates communications among stakeholders throughout the application process, and, according to FAA, routinely makes information about the program available through its public website and presentations.⁴⁷ Technical assistance focuses on guidance for completing an application that adheres to the provisions set forth by FAA. FAA staff have also provided technical assistance to applicants in submitting an accurate map of all airport properties that would be transferred to the private-sector airport operator. FAA staff also review airport lease agreements between the public sponsor and private operator to ensure that the proposed lease complies with federal laws and regulations. FAA headquarters and regional staff stated that after providing applicants with written acceptance of their preliminary application, staff educated bidders

⁴⁶49 C.F.R. §.1.83(a)(9).

⁴⁷Regionally, FAA field staffs provide technical assistance and review airport sponsor applications, including Part 139 certification for transfer of ownership, and assist with review of applicants' airport property maps.

and public-sector airport owners about the APPP process and provided technical assistance.

Under authority delegated by the Secretary, included in administration of the pilot program, the FAA Administrator is also responsible for approving certain exemptions to waive grant repayment and to allow revenue diversion from the sale or lease of the airport.⁴⁸ Based on review of the sponsor's application and proposal, the FAA Administrator decides which exemptions, if any, should be granted based on an established list of considerations.⁴⁹ For example, at Luis Munoz Marin, the FAA Administrator waived about \$49 million in grant repayment for the PRPA because Luis Munoz Marin would continue to function as a public airport and all AIP-funded facilities and improvements would continue to be used for the purposes of the original AIP grant.⁵⁰ The FAA Administrator granted approval of the PRPA's use of lease proceeds for general purposes since the request had been approved by more than 65 percent of air carriers and since funds used for debt reduction would allow PRPA to make future investments in both ports and regional airports.⁵¹ Similarly,

⁴⁸The amount waived includes the value of land acquired with federal financial assistance or the value of grant-funded capital improvements including equipment. ACRP, Report 66: *Considering and Evaluating Airport Privatization*.

⁴⁹49 U.S.C. §47134(c) contains nine provisions for FAA approval of an APPP application. The sale or lease agreement must demonstrate that (1) the airport will continue to be available for public use on reasonable terms and conditions and without unjust discrimination; (2) the operation of the airport will not be interrupted if the private operator experiences bankruptcy or other financial difficulty, (3) the private operator will "maintain, improve and modernize" airport facilities through capital investments and submit a plan for these actions; (4) airport fees imposed on air carriers will not increase faster than inflation unless approved by 65 percent of air carriers having at least 65 percent landed weight at the airport; (5) the percentage of increase in fees imposed on general aviation operators will not exceed the percentage increase in fees imposed on air carriers; (6) safety and security will be maintained at the highest possible levels; (7) adverse effects of noise from operations at the airport will be mitigated to the same extent as the public airport; (8) adverse effects on the environment from airport operations will be mitigated to the same extent as the public airport; and (9) any collective bargaining agreement that covers airport employees is in effect on the date of the sale or lease will not be abrogated by the sale or lease. FAA has waived the requirement to pay back the federal grants for both airports that have privatized under the APPP.

⁵⁰This amount is based on FAA's calculation of the unamortized value of AIP investments made to benefit Luis Munoz Marin from 1992 through 2012.

⁵¹FAA, *Record of Decision for the Participation of Luis Munoz Marin International Airport, San Juan, Puerto Rico; In the Airport Privatization Pilot Program* (Washington, D.C.: Feb. 25, 2013).

about \$59 million in grant repayment was waived for Stewart because the airport would continue to function as a public airport and AIP grant-funded facilities would maintain use for the purposes of the original grant. For Midway, FAA officials estimated that about \$145 million would have been waived if the privatization had been finalized and a full waiver of grant repayment had been made.⁵²

Several Factors Limit Demand for Privatization, yet the Potential Benefits of Private Investment and Expertise Can Be Achieved without Relinquishing Airport Control

Financial Considerations Can Reduce Demand for Privatizing U.S. Airports despite APPP

Financial considerations reduce both public and private sector demand for privatizing airports in the U.S. as demonstrated by only two airports successfully completing the privatization process under the APPP since 1997.⁵³ Fundamentally, for an airport privatization to occur, the private operator must be able to make a profit and the public-sector airport owner must believe that more will be gained than lost in the transaction. The first key consideration to private-sector airport operators and investors is their generally higher borrowing costs than the public-sector airport owner due to the private sector's inability to issue tax-exempt bonds. For example, an airport privatization expert we spoke with stated that one obstacle

⁵²FAA officials estimated this amount from their calculation of the unamortized value of the investments made to benefit Midway through 2010.

⁵³In addition to the considerations listed below, privatized airports have a higher matching requirement for AIP discretionary grants—30 percent for privatized airports versus 10 to 25 percent for public-sector airport owners. With less access to federal funding, the value of the privatization to the private sector may be reduced to compensate for greater financing costs.

barring more airport privatization is the private-sector airport operator's lack of access to tax-exempt bond financing increasing the borrowing costs when compared to public-sector airport owners. In addition, representatives from a financial institution we spoke with said that public-sector airport owners have the access they need to finance their capital investments with tax-exempt bonds. Even though there has recently been a narrowing in the differential in interest rates between tax-exempt and taxable bonds, prospective private sector airport owners may still find it difficult to gain sufficient operational efficiencies upon privatization to overcome the higher costs of financing they face compared to public-sector airport owners. A recent report by the House of Representatives, Committee on Transportation and Infrastructure's Special Panel on Public-Private Partnerships found that one major reason why the U.S. public-private partnership market has not grown as quickly as in other countries is that those countries do not offer tax-exempt municipal bonds. The Panel found that the U.S. possesses a robust municipal bond market of approximately \$3.7 trillion, of which a significant portion is for infrastructure financing, is one major reason why the potential for public-private partnerships in the United States is limited. The Panel also found that given the private sector's higher cost of capital, airport public-private partnerships will only work in certain circumstances, usually involving budget constraints or airports that have historically not been well managed.⁵⁴ Current Internal Revenue Service (IRS) regulations significantly limit the ability to transfer outstanding tax-exempt debt to the private sector operator.⁵⁵ As a result, the airport's outstanding tax-exempt debt must be paid off by the public-sector airport owner prior to a private sector transfer, leaving the private-sector airport operator to finance the acquisition and any future capital improvements with generally higher-cost taxable bonds and equity investments.⁵⁶ The 2012 ACRP report on

⁵⁴Special Panel on Public-Private Partnerships, Transportation and Infrastructure Committee, U.S. House of Representatives, *Public-Private Partnerships: Balancing the Needs of the Public and Private Sectors to Finance the Nation's Infrastructure; Findings and Recommendations of the Special Panel on Public-Private Partnerships* (Washington D.C.: Sept.17, 2014).

⁵⁵Internal Revenue Service Regulations, 26 C.F.R. §§ 1.141-12 and 1.142-2.

⁵⁶Although, as stated earlier, a public sector entity can issue tax-exempt Private Activity Bonds for investments in a privatized airport.

airport privatization also noted that the tax-favored status of U.S. public municipalities is a significant deterrent to full privatization.⁵⁷

Privatized airports (within and outside the APPP) also may not be entitled to local and state property tax exemptions, unless specifically authorized, and would likely not be exempt from tort liability claims. In the Midway airport example, City officials had to negotiate with state lawmakers to maintain Midway's property tax-exempt status and the state enabling legislation required the city to dedicate 90% of lease proceeds to fund capital infrastructure and maintenance or to fund municipal employee pension funds. According to the recent ACRP report on airport privatizations, with reduced protections for tort liability claims, privatization (within and outside the APPP) may create greater tort liability risk for a private operator than a public operator in the event of, for example, an aircraft accident, since the private operator would not likely be entitled to same immunities as a public entity.⁵⁸

While increased financing and other costs have not eliminated private sector interest in airport privatization in the United States, those factors, when combined with others discussed below, have reduced the range of airports that may be interested in privatization. These factors may also help explain the lack of interest by public-sector airport owners in pursuing full privatization under the APPP. Further, until the Luis Munoz Marin privatization, there has not been an example of privatization in the United States for the completion of the full privatization process. Two industry experts we spoke with said that if the privatization of Midway airport had been successful, it could have increased the visibility of airport privatization in the US and demonstrated the benefits of private sector involvement. A successful privatization would also have to overcome any negative perceptions and mistrust from some in the public and local communities about private sector ownership of a public-use facility.

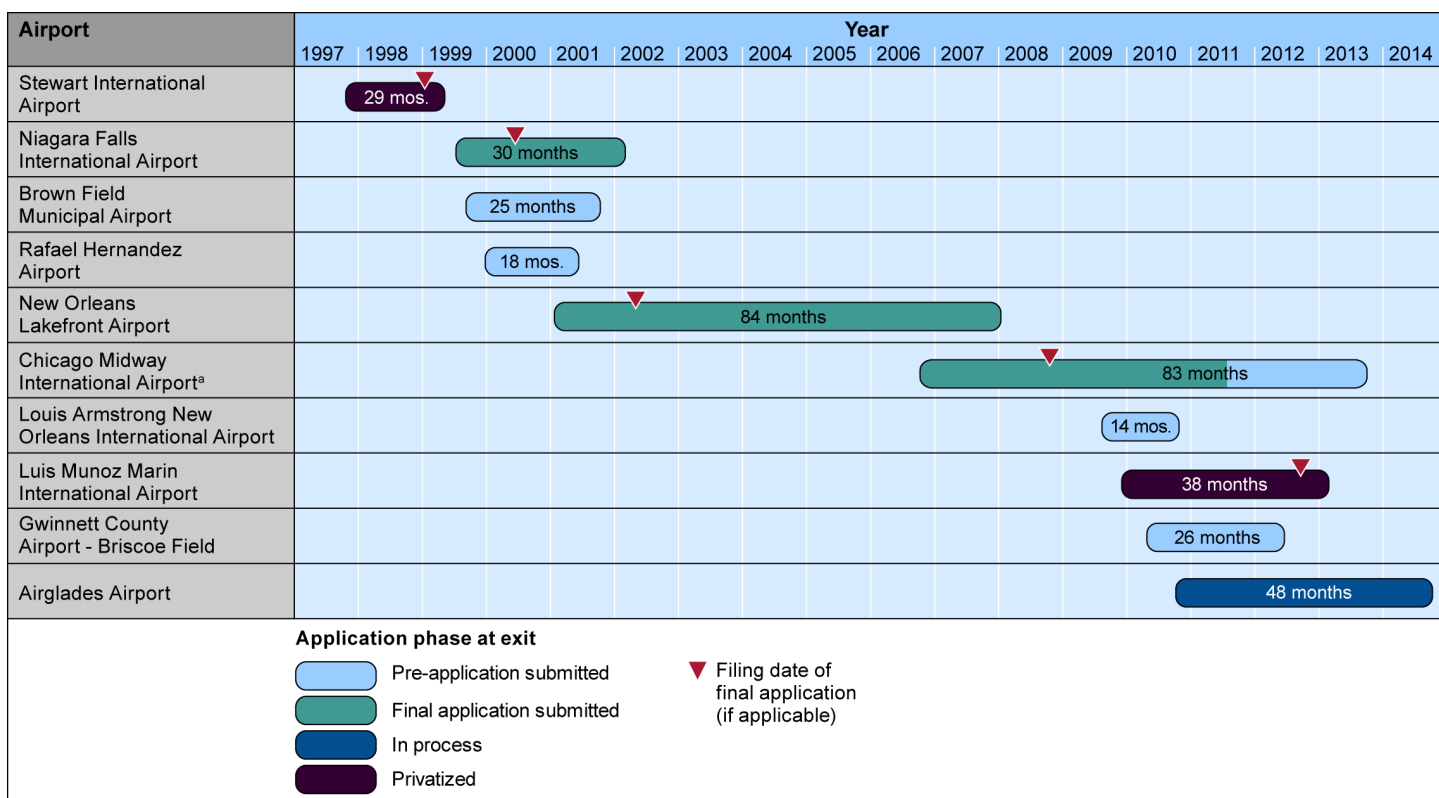
⁵⁷ACRP, Report 66: *Considering and Evaluating Airport Privatization*. However, as noted above, public sector entities can issue tax-exempt Private Activity Bonds on behalf of a private sector airport operator. For example, the tax-exempt status of Branson Regional Airport Transportation Development District allowed for the issue of tax-exempt private activity bonds on behalf of the private corporation that developed and operates Branson Airport.

⁵⁸ACRP, Report 66: *Considering and Evaluating Airport Privatization*.

APPP Application Process Can Be Time Consuming and Costly

Applicants to the APPP and other key stakeholders involved in the process said that the application process presented several challenges that added to the risks, and thus costs, of pursuing privatization. According to public airport owners, airport stakeholders, private sector investors, and the FAA, a successful transfer of airport control required the public owner and its team of consultants, and advanced-stage private sector bidders to address several challenges including obtaining airline consent, ensuring due diligence in following the FAA's application procedures, and mitigating external risk factors such as navigating public opinion and political scrutiny. This process, whether or not the application ultimately resulted in privatization of the airport, took significant time, ranging from 14 to 84 months (see fig. 5 below). FAA officials said that some airports might initially seek to structure deals to use the proceeds from privatization for non-airport purposes, which the FAA reviews to determine if the overall benefits of the deal are such that a waiver of the use of the proceeds for non-airport purposes is warranted. Therefore, FAA officials noted that the privatization process can be lengthy because FAA has been exercising due diligence to ensure all APPP rules are followed and because commercial entities take a long time to structure their deals.

Figure 5: Length of Time an Applicant Was Active in the APPP, 1997–2014 (in Months)



Source: GAO summary of FAA docket information. | GAO-15-42

^aThe City of Chicago terminated its lease agreement with the private operator in April 2009 following the private operator's unsuccessful attempt to secure financing. In 2011, the City submitted supplements to the original final application as well as an extension request and a revised preliminary application that was approved and enabled the City to complete another round of bid requests until spring 2013 when the City withdrew its application due to too few qualified bidders.

We spoke with key public sponsor representatives of two of the three APPP applicants that reached the final application phase. They discussed the planned as well as unanticipated consequences of lengthy and costly application procedures, support and learning resources required throughout, and risk factors that increased uncertainty.

- **Lengthy airline consent negotiations**—Public-sector airport owners, consultants, and private investors that we spoke with all said that obtaining the 65 percent consent from airlines to use lease or sale proceeds from privatizing the airport for non-airport purposes was the pivotal and most time-consuming requirement of the application process. As depicted in figure 5 above, the privatization process for

the Luis Munoz Marin and Midway airports took a total of 38 and 83 months, respectively. Within those time frames, it took 25 months for PRPA to obtain airlines' consent for Luis Munoz Marin, and a combined 26 months for Midway's airline agreement for both privatization efforts. Stewart was unable to obtain airline approvals to use airport revenue for non-airport purposes; the airport's owner, New York, agreed to use the lease payments for airport purposes and to recoup past state investments in Stewart and other state-owned airports, in accordance with FAA's airport revenue use policy. For Luis Munoz Marin and Midway, PRPA and City of Chicago officials said that it takes significant time to arrive at an agreement with the airlines, then submit the agreement to FAA for review, and then share the agreement with advance-stage private bidders for bid proposals and negotiation purposes. Additionally, the private sector airport stakeholders and PRPA representatives we interviewed said that airlines' negotiations added an additional layer of complexity and that they believed the purchase transaction should be strictly between the public "seller" and the private "buyer." Representatives from two airlines that occupied the position of having dominant air traffic at Midway and Luis Marin Munoz airports at the time of airports' applications said that it could potentially be more efficient if a dominant airline assumed the responsibilities of coordinating the negotiation with other carriers. Overall, the airline representatives we spoke with said they were satisfied with their arrangements, while the public airport owners said there was extra work and time expended to get to an agreement with the airlines.

- **Evaluation and preparation of privatization deals by the public airport sponsors can be costly**—Because APPP applicants must satisfy local, state, and federal requirements as well as potential investors, the process of drafting the final airport use and lease agreements becomes complex, requiring outside expertise. For example, the City of Chicago spent \$13 million overall on privatization-related transaction costs in the first application, and \$3.5 million in the second round, with both attempts failing to result in privatization. The Puerto Rico Public-Private Partnerships Authority spent \$17.4 million in project costs from December 2009 to February 2013 that included but were not limited to costs associated with feasibility studies, legal counsel, financial consulting, engineering and technical consulting, and personnel and operating costs and service

charges.⁵⁹ Costs also included the estimated statutory fee payable to the IRS as a result of the elimination of tax-exempt bonds attributable to the airport.

- **Public opposition**—Public opposition to privatization can undermine the public-sector airport owner’s interest in privatization unless the goals and benefits are clearly stated. The community association we spoke with in San Juan said that public concerns can potentially impact public-sector airport owners during the privatization process. In Chicago, two public interest groups we interviewed said that in their view, the first round of privatization of Chicago’s Midway Airport was not transparent and had limited public input. A representative of one of those public interest groups said that the State of Illinois tried to remedy this when it passed enabling legislation for the privatization of Midway.⁶⁰ In San Juan, a community association we spoke with said that there were public concerns about the privatization, including over the foreign ownership of the bidder. The FAA public docket included written public comments and summarized responses from PRPA on how it and Aerostar intended to address those concerns.⁶¹ The Puerto Rico Public-Private Partnership Authority also provided public notice about the privatization of Luis Munoz Marin on its web site.
- **External factors can also undermine success**—External factors can affect the outcome for public owners and influence decision-making by private investors. Given the lengthy timetable for consideration, application, and review, changes in economic or political climates can influence whether a deal is consummated.
 - **Macro-economy**—Changes in the economy, such as the onset of a recession, can alter the value and outcome of a privatization of a deal. In the first Midway privatization effort, a lease agreement

⁵⁹The payment structures for compensating private consultants varied, for example, the Puerto Rico Public-Private Partnership Authority paid for these costs but was reimbursed with money from the \$615 million in lease proceeds.

⁶⁰The legislation required that all proceeds from the lease be used by City of Chicago, the lessor, for either pensions or infrastructure investments.

⁶¹Public meetings were held and written comments were collected and published in the public docket. Summaries of select public comments and PRPA and Aerostar responses were included in the FAA’s Record of Decision outlining the final approval of PRPA to enter and execute a 40-year lease agreement with Aerostar for the lease of Luis Munoz Marin International Airport.

with a bidder was reached but failed to close, in part, because broader financial problems in the economy left the private bidder unable to secure sufficient financing. Since then, the FAA has placed greater scrutiny on the potential private bidders' proposed funding and financing and applied this lesson when reviewing the Aerostar bid for Luis Munoz Marin.

- **Shifting political agenda**—In 1996, the city of San Diego entered into an agreement with a private sector developer, Brown Field Aviation Park LLC, to implement a comprehensive redevelopment of Brown Field, a general aviation reliever airport, into an air cargo hub and general aviation airport. After submitting a preliminary application to the APPP in 1999, the City withdrew from the pilot program in 2001 due, in part, to diminishing support from elected officials and over concerns and opposition among the community of the potential adverse affects of the airport's being redeveloped into a cargo hub. Civic and public interest associations and airport experts we spoke with said that the decision to privatize municipal assets, such as airports, can involve a highly political decision-making process. One private-sector airport investor stated that political uncertainty reduces the private sector's willingness to invest in an airport as well.
- **Performance risks**—Even after privatization occurs there is a risk of poor performance by the private-sector airport operator if the lease is not properly executed. In the case of the Stewart, as previously discussed in this report, NEG shifted its business focus from airports soon after it assumed the lease. NEG managed the airport for immediate financial return and was not interested in investing in the airport. As noted above, the airport was acquired by the PANYNJ in 2007 after 7 years under private operation. The PANYNJ officials we spoke with said that the Port Authority made far greater investments compared to NEG to bring the airport up to Port Authority standards and to retain a key airport tenant.

Public-Sector Airport Owners Can Attract Private Capital and Expertise without Ceding Airport Control

Public-sector airport owners have found ways to raise private sector investment in their airports and attract expertise without ceding control of their airports. A recent report by the House of Representatives, Committee on Transportation and Infrastructure’s Special Panel on Public-Private Partnerships similarly found that airport owners have partnered with airlines and others for terminal modernization programs.⁶² Two public-sector airport owners we spoke with that explored but chose not to go through the APPP or instead sought access to private capital for projects, said they wanted to retain control of the airport and obtain private capital and airport operation and management expertise, all within a quicker timeframe.⁶³ In addition, three private-sector airport stakeholders we spoke with said that public-private partnerships can achieve many of the same goals as full privatization.⁶⁴ Furthermore, some of these private sector stakeholders said that the public-private partnerships take significantly less time than undergoing full privatization because such partnerships involves fewer parties and less outside review. The following examples of different types of private activity at major commercial service airports demonstrate that many of the benefits of full privatization can be achieved without ceding airport control.

- **Gary International Airport management and development contracts**—The City of Gary, Indiana, wanted to expand Gary International Airport, improve its management, and seek economic

⁶²Special Panel on Public-Private Partnerships, *Public-Private Partnerships: Balancing the Needs of the Public and Private Sectors to Finance the Nation’s Infrastructure; Findings and Recommendations of the Special Panel on Public-Private Partnerships*.

⁶³As previously discussed in this report, service contracts refer to the outsourcing of non-core operations to a private entity with expertise in operation, maintenance or management of the non-core airport activity. Management contracts entail the public sponsor contracting out the management and operation of parking facilities, terminal concessions, terminal operations, or the entire airport system to a private operator. With a management contract, the public sponsor retains control of airport functions including airline use agreements, federal grants compliance, debt issuance, rates and charges governance; and environmental, long-range planning, capital improvement programs, and airport economic development. Developer financing or operation agreements involve the private sector’s providing capital investment in projects such as passenger terminal construction, cargo facilities and other major airport facilities. The private sector can provide full-scale development, operation, and maintenance services as well as financing through lease or concessions of the facilities under a developer-financing/operating agreement.

⁶⁴The private firms we met with included financial investors and expert airport operators with airport properties financed, owned, or operated in the United States and abroad.

development in the community, without relinquishing municipal control to a private operator.⁶⁵ In January 2014, the Gary/Chicago International Airports Authority entered into public-private partnership that includes a 10-year management contract (with up to 30 years of extension) with private operator AvPorts and a multi-year development agreement with a related development firm, AFCO, to outsource both airport operations and to spur economic development on and around the airport. Both the Gary City officials and the private operator representatives said that the process took less than one year and was a positive collaborative effort that allowed each party to take advantage of specific benefits, and both said that a full privatization would have been a complex, lengthy process and limited these outcomes.

- **LaGuardia International Airport terminal developer contract**—The PANYNJ sought bids for the redevelopment of the airport's current central terminal from October 26, 2012, through January 25, 2013.⁶⁶ According to a Port Authority official, the PANYNJ lacked sufficient financing to undertake the project on its own as it would have taken too much time to accumulate the funds to do so. According to the PANYNJ, the terminal project calls for a new 1.3-million-square-foot terminal with 35 gates and will include the replacement and financing of the central terminal building, including roads, utilities, a central heating and refrigeration plant, and other support facilities. Additionally, the winning bidder must also work with the PANYNJ in operating the existing central terminal during construction, manage the transition of airline and non-airline tenants to the new facility as well as operate and maintain the plant and the terminal building for a specified term. The private sector investors will receive a portion of the central terminal building's revenue in return for their investment. Presently, the PANYNJ has narrowed the bidder to three prequalified teams.

⁶⁵Gary officials contacted FAA to explore the APPP option but opted for a management contract and shared draft contracts with FAA. The officials also collected information on best practices about privatization efforts from FAA and conducted public outreach to educate the community about the partnership with private operators prior to adopting the airport management and development contracts.

⁶⁶This project is valued at \$3.6 billion and entails the designing, building, financing, operating and maintenance of the redeveloped terminal.

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- **Detroit Metropolitan Airport, McNamara Terminal**—This \$1.2 billion terminal project was completed in 2002 and included 97 gates, baggage area, parking garage, an indoor tram, and shops and restaurants. The project was financed through a public-private partnership between Northwest Airlines and the airport sponsor, Wayne County, with a major portion of the project funded through PFC revenues and associated airside projects funded through AIP grants. The airline acted as the developer and general contractor of the project, and continues to operate it today. Wayne County retains ownership rights to the terminal.
 - **Indianapolis International Airport management contract**—As reported by ACRP, in the 1990's, the mayor of Indianapolis pursued privatization as a way to address pension funding deficits, meet unfunded infrastructure needs, and provide jobs and attract economic development. The Indianapolis Airport Authority (IAA), the public sector airport owner, considered full sale or lease of its general aviation and commercial airports but decided that getting regulatory approval would be difficult.⁶⁷ Therefore, the IAA entered a 10-year management contract with British Airports Authority (BAA) to manage its system of general aviation airports and Indianapolis International Airport. BAA contracted to manage the airport and attract new airline service, increase nonairline revenues, reduce operating expenses, improve customer service, and improve the diversity and expertise of airport staff. The BAA earned a management fee annually based on how much it helped airlines save on costs per passenger. BAA and the Airport Authority agreed to an extension of the management contract to 2008, with the extension to include a major terminal redevelopment project. As the initial operating efficiencies were realized, it became difficult for BAA to obtain further financial returns. And as the compensation formula became unwieldy to calculate for both BAA and the Authority, both parties agreed to terminate the contract early in 2007, and the airport system was returned to public sector management. According to ACRP's case study of the airport, most airport staff were transferred back to IAA with increased and diversified skills and the airport system saw an increase in airline traffic.⁶⁸

⁶⁷The FAA implemented the APPP in September 1997 with the issuance of the program's application procedures.

⁶⁸ACRP, Report 66: *Considering and Evaluating Airport Privatization*.

In addition, FAA officials noted that many airports have considered changes in ownership, governance structure, or day-to-day management for a broad range of reasons, including avoidance of personnel or procurement restrictions, lack of agility in policy-making and operational control. The officials noted that municipally-owned airports considering privatization may learn of other available solutions to their challenges including simple transfer to a single-purpose airport authority. In 2009, ACRP reported that airport ownership transfers from general government departments to single-purpose or limited-purpose government or private entities were on the rise.⁶⁹ ACRP's recent report on airport privatization also suggests that a single purpose airport authority may not be attracted to privatizing any of its airport assets under the APPP because such an authority will likely not have any desire, incentive or even ability to transfer sale or lease proceeds from a privatization to general government programs outside its purview.⁷⁰

Potential Effects of Airport Privatization Are Difficult to Determine

We found that the potential effects of airport privatization on airport efficiency, the Federal Airport and Airway Trust Fund, federal tax revenues, and airport employees and concessionaires are difficult to estimate.⁷¹ As discussed below, this difficulty is partly due to the lack of experience with privatization in the United States, as well as the wide array of potential variables that could affect the viability of a particular airport privatization.

- **Efficiency of airport operations**—Privatization may not significantly affect the efficiency of U.S. airports. Fourteen of the 42 airport stakeholders and experts we interviewed noted that one benefit of airport privatization tends to be greater efficiency in airport operations due to the private-sector airport operator's profit motive which contrasts with public-sector airport owners' goals that can compete with efficiency, such as increasing local employment or satisfying community or environmental concerns that may result in more expensive labor and procurement costs than private-sector airport

⁶⁹ACRP, *Legal Research Digest 7: Airport Governance and Ownership* (Washington, D.C.: August 2009).

⁷⁰ACRP, Report 66: *Considering and Evaluating Airport Privatization*.

⁷¹In this context, efficiency refers to what economists call "technical" efficiency—providing goods or services at the lowest cost.

operators may have. As a result, some of these stakeholders argue that a private owner may be more likely than government sponsors to find the greatest efficiencies in operations. However, as discussed earlier, there already is extensive private-sector involvement at U.S. airports, particularly for non-aeronautical operations, such as parking and food service, which are operated by private-sector vendors or concessionaires. Similarly, airlines and outside groups have invested in airport facilities, such as in new terminals, which have provided private sector input into the airport's management decisions and incentives to control costs for both the private and public sector. Finally, on the airside of airport facilities, private sector airport operators may also still be bound by the same AIP grant obligations that public-sector airport owners are, such as prevailing wage laws or Buy America provisions, thus reducing the potential efficiencies that may be achieved by transferring airport operations to the private sector. Some academic research has examined efficiency outcomes under various airport ownership structures and found mixed results as to the extent that privatization enhances the efficient operations of airports.⁷²

- **Federal expenditures**—Airport privatization would likely have little or no impact on expenditures out of the Federal Airport and Airway Trust Fund. As stated above, airports privatized through the APPP are eligible for AIP grants albeit with a larger matching contribution for AIP discretionary grants. We reviewed capital improvement information that was submitted by seven airports seeking to privatize through the APPP, and found that all of them depended on capital investments

⁷²For example, in a study on privatization of British Airports Authority (BAA) airports that took place in the mid-1980s, Parker found that privatization did not appear to affect the technical efficiency of the airports, and that instead, efficiency was driven by the varied efficiencies of the airports that were part of BAA over time. See Parker, David, "The Performance of BAA before and after Privatisation: A DEA Study", *Journal of Transport Economics and Policy*, Vol. 33, No. 2 (1999). Additionally, work by Oum et al. (2006) and Oum et al. (2008) suggests that efficiency outcomes may have a complex relationship to ownership structures. Specifically, while fully private ownership appeared to be more efficient than varied forms of government ownership in these studies, full government ownership was more efficient than certain forms of shared government-private ownership. See Oum, Tae H., Nicole Adler, and Chunyan Yu, "Privatization, corporatization, ownership forms and their effects on the performance of the world's major airports", *Journal of Air Transport Management*, Vol. 12, (2006) and Oum, Tae H., Jia Yan, and Chunyan Yu, "Ownership forms matter for airport efficiency: A stochastic frontier investigation of worldwide airports", *Journal of Urban Economics*, Vol. 64, (2008).

from AIP apportionment grants.⁷³ At the same time, the amount of taxes paid into the trust fund by airline passengers would not change if an airport privatized. Nevertheless, to the extent that privatized airports receive reduced AIP grants, those funds would presumably become part of the total available AIP grant funds provided to other airports, leaving the total disbursements from the trust fund unchanged.

- **Federal tax revenues**—The extent to which an airport privatization would affect federal tax receipts is difficult to estimate because many of the determining factors are unknown. The factors that would determine the net effect of a full airport privatization on federal tax revenues include:
 - whether the government owner of the airport provides tax-exempt financing for the airport facilities through qualified private activity bonds under the privatization arrangement;⁷⁴

⁷³The seven airports that we reviewed capital information were from: Louis Armstrong International Airport and New Orleans Lakefront Airport in New Orleans, LA; Midway International Airport in Chicago, IL; Luis Munoz Marin International Airport in San Juan, PR; Niagara Falls International Airport in Niagara Falls, NY; Gwinnett County Briscoe Field, in Lawrenceville, GA; and Stewart International Airport in Newburgh, NY. Midway, Louis Armstrong, Stewart, and Luis Munoz Marin airports were all commercial service airports when they submitted their capital improvement information.

⁷⁴Qualified private activity bonds are tax-exempt bonds issued by a local or state government to provide financing for specified privately used facilities. Such bonds may be used to finance investments in airports as long as the latter remain technically owned by a government. The provision of tax-exempt financing can have additional, indirect effects on federal revenues, which depend on how, if at all, that financing affects the upfront payment that the government requires for participation in the privatization. If the government demands a higher payment if it commits to tax-exempt financing for the deal than it would demand if it did not provide that financing, that payment increase would reduce the investor's return, and, thereby, the amount of tax it would pay. If the government does not require a higher payment in return for the tax-exempt financing, then the investor's return and tax payments would be higher than would have been the case without the subsidized financing.

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- the type of entity the new investor is and, if it is a pass-through entity such as a partnership, the type of taxpayers its partners are;⁷⁵
 - the profitability of the new investor, as determined according to federal tax rules;⁷⁶
 - the extent to which the taxable incomes of independent concessionaires operating at the airport are affected by the privatization;⁷⁷
 - the amount of federal taxes, if any, that the investor would have paid on income from the alternative investment it would make if it did not participate in the airport privatization; and

⁷⁵Pass-through entities, such as partnerships, do not pay taxes themselves; rather they pass through their profits and losses to their partners, which include those amounts on their own tax returns. Generally, the partners pay tax on the income in the year in which it is earned. However, if the partner is a tax-exempt entity, such as a public employee pension fund, then the income will not be taxed until it is paid out as pensions to individual participants. One lawyer who has advised several airport and highway privatizations noted that such pension funds have participated in these investments. The private sector leaseholder of Luis Munoz Marin International Airport, Aerostar Airport Holdings LLC (Aerostar), is organized under the laws of Puerto Rico. Consequently, any income it may receive from the operation of that airport would not be subject to U.S. tax unless the income was repatriated to U.S. shareholders or partners. (Aerostar is 50-percent owned by a Mexican company.)

⁷⁶The specific tax rules that would apply will depend on the particular terms of agreement and circumstances of each privatization. Under certain conditions, the investor would be able to claim federal tax deductions for depreciation and/or amortization with respect to the upfront payment made to the government owner. Depreciation is the accounting process of allocating against revenue the cost expiration of tangible personal property, plant, and equipment. Amortization is a similar accounting process that is applied to certain intangible property, such as a franchise right to collect fees, under the federal tax code. The investor would also be able to deduct expenses related to ongoing business operations, as is typically allowed under the tax code.

⁷⁷Additional investments and improved operations by the new private investor could lead to an overall increase in those incomes, or those incomes could decline if the overall operations of the airport deteriorate or if the new investor captures a larger share of those incomes through higher rental charges. Although the new investor's appropriation of a larger share of the incomes may not decrease the aggregate private income generated by the airport, it would shift that income across entities and, thereby, may change the rate at which that income is taxed because effective tax rates can vary across different businesses.

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- the use that the public owner makes of whatever payment it receives from the investor.⁷⁸

It is not possible to make general predictions about these factors with respect to potential future privatizations. Even in the case of actual privatizations, little can be determined about some of these factors without access to the detailed financial and tax records. In addition, other factors, such as the best alternative investment available to the private investor and the use that the government owner makes of the payments it receives, cannot be determined.⁷⁹ Nevertheless, any positive effect that a full airport privatization has on federal revenues is likely to be limited, unless the only alternative investment opportunity that the private investor had would be significantly less profitable than its investment in the airport. Nor is any full airport privatization likely to have more than a limited negative effect on federal revenues, unless the new private investor generates significant tax losses from the airport investment that it then uses to offset taxable income earned from other investments. (Current government owners of airports do not pay tax on any returns that they get from those investments, so federal revenues would only decline if the new owner, in effect, paid negative taxes.) Although such a result is possible, unless the investor can generate significant tax losses without also generating real financial losses, the investor would not undertake the investment for that purpose.

- **Airport employees and concessionaires**—The effect of airport privatization on labor and concessionaires is also airport specific. While existing labor contracts cannot be abrogated or modified by an airport privatization under the APPP, the public sector airport owner may add other labor or concessionaire protections.⁸⁰ For example, the private sector operator selected under the first privatization attempt of Midway was required to adhere to Chicago's disadvantaged business

⁷⁸For example, if the public owner did not have to issue more tax-exempt debt because of the payments, federal tax revenues could increase.

⁷⁹The government's detailed use of the payment would be difficult to determine with certainty due to the general fungibility of government funds.

⁸⁰Under the APPP, any collective bargaining agreement that is in effect on the date of the sale or lease shall not be nullified by the sale or lease. 49 U.S.C. § 47134(c)(9). However, a private sector airport operator would have had or has the ability, just as the public sector owner would have, to renegotiate labor contracts once they expired as well as renegotiating or opening up concession contracts for competition.

and prevailing wage requirements, and for the second privatization attempt, City of Chicago officials stated that while the APPP did not require it, every city employee at Midway would have a position with similar employment terms and conditions at either the new operator's company or the city. In addition, while all of the Puerto Rico Ports Authority employees at Luis Marin Munoz were interviewed for jobs with Aerostar, according to Aerostar representatives, Aerostar was not required by either the APPP or the terms of the agreement with PRPA to re-hire those employees. Many PRPA employees at the airport chose to stay with the PRPA. For example, out of the 400 employees from the managerial staff, only about 15 accepted jobs with Aerostar. Union officials we spoke with who represent the managerial staff affected stated that so few accepted Aerostar's offer because they did not know what their jobs were going to be and therefore chose either to remain with PRPA or to retire. Existing concessionaires may also be affected by privatization. We spoke with two concessionaires at Luis Munoz Marin who believe that the new airport operator is infringing their long-standing concession agreements, and they are currently trying to resolve their disputes with PRPA and Aerostar.

Airport Privatization Is More Prevalent in Other Countries and Stakeholders' Views on Privatization Vary Widely

Different Airport Ownership Structures, Motivations, and Financing Drives Airport Privatization in Other Countries

There are several reasons why privatized airports are more prevalent in other countries than in the United States. At least 450 airports around the world have some form of private-sector participation in their management or ownership.⁸¹ First, in several countries the national government built, owned and operated the country's airports prior to privatization. The International Civil Aviation Organization (ICAO) has examined the efforts

⁸¹Reason Foundation, *Annual Privatization Report 2014: Air Transportation* (Los Angeles, CA: March 2014).

of 25 countries to privatize their airports. Prior to privatization, the national government in 19 of those 25 countries owned all or most of the major airports in those countries. National ownership of airports allows the central government to direct the sale of their airports and can make for a more streamlined privatization transaction, reducing transaction costs for both the public-sector owner and private-sector bidders. For example, seven private-sector airport stakeholders we interviewed stated that international airport privatization transactions have tended to involve the seller (such as the national government) and prospective buyers with no other stakeholder involvement (such as local governments, airlines, labor, etc.). In contrast, as we have noted above and as Congressional Research Service (CRS) has reported, U.S. airport privatization transactions involve four major stakeholders (public-sector airport owners, private sector investors, airlines and the federal government), each representing different and often competing interests in an airport privatization. This adds a complexity that is generally not present elsewhere.

Second, foreign governments may be more motivated to privatize their airports than U.S. public sector airport owners may. According to ICAO, the reasons these governments had for privatizing their airports varied, including need for private sector capital investments in existing or new airports and a national move toward privatization of public assets or companies. For example, the government of the United Kingdom privatized the airports it owned in 1987 as part of a larger program of denationalization of nationally-owned industries and utilities. More recently, the national government of Brazil privatized several major airports to secure private sector investments in those airports prior to the 2014 World Cup and 2016 Olympics. In contrast, only Ronald Reagan Washington National Airport and Washington Dulles International Airport are owned by the federal government, with the rest owned by state, regional, or local governments—making a national decision to privatize U.S. airports much more unlikely.⁸²

Third, airports in other countries have less access to public funds or tax subsidies than publicly-owned and operated U.S. airports, making them more reliant on private financing for airport improvements. As we have

⁸²Both Ronald Reagan Washington National Airport and Washington Dulles International Airport are leased to the Metropolitan Washington Airports Authority under a 50-year lease, effective June 1987, with an amendment extending the term to 80 years to 2067.

noted above, a key consideration for U.S. airport privatization is the loss of some AIP funds and the loss of easy access to tax-exempt financing. For example, the House Transportation and Infrastructure Committee's Panel Report found that a major reason why public-private partnerships were more common overseas was due to the lack of access to tax-exempt financing that exists in the United States. Since the owners of foreign airports generally do not have these financial advantages, they do not have to account for their loss when privatizing and, according to CRS, would not necessarily have greater capital costs if they were to privatize.⁸³

Stakeholders Provided a Wide Variety of Views on Lessons Learned from U.S. and Foreign Airport Privatizations

To address some of the challenges to airport privatization that we identified, such as the length of time and complexity of negotiations, 31 of the 42 airport stakeholders and experts we interviewed provided a wide variety of insights from their experiences with both international and U.S. airport privatizations and cited various lessons learned.⁸⁴ See appendix II for the full list of the lessons learned mentioned by stakeholders. The three lessons learned most frequently mentioned were:

- **Ensure that the public-sector airport owner conducts due diligence prior to privatization**—To varying degrees, nine stakeholders stated that the public sector airport owner should ensure that it establishes goals for privatizing the airport, know the value of the airport, and understand the process for privatizing the airport. The privatization effort may be jeopardized if these activities are not completed prior to starting the privatization effort. For example, according to one private-sector airport consultant we interviewed, public officials at one airport the consultant was familiar with decided to privatize without knowing what privatization would entail, what they wanted to achieve from privatization, and how much the airport was worth by obtaining an independent evaluation of the airport's value. As a result, the public-sector airport owners decided that the private sector response to their request for qualified operators was inadequate and the airport's privatization application was withdrawn. In contrast, according to a private sector airport consultant and the

⁸³CRS, *Airport Privatization: Issues and Options for Congress* (Washington, D.C.: May 2014).

⁸⁴Eleven stakeholders interviewed did not offer any lessons learned.

officials responsible for the Luis Munoz Marin privatization and for the Gary airport agreements, the public airport owners at both airports established clear objectives, engaged consultants to independently determine the value of the airport, created reports detailing this information, and held outreach and public comment meetings—all of which had a positive effect on public support to finalize these deals. For example, the Puerto Rico Public-Private Partnership Authority conducted a study that was released to the public prior to submitting the application to the APPP outlining the options for Luis Munoz Marin and that showed the reasons why Puerto Rico should privatize that airport.⁸⁵

- **Create a transparent privatization process**—Seven stakeholders suggested that public airport owners should lay out an open process with a schedule showing major milestones as to how their airport will be privatized, a process that one stakeholder stated could increase stakeholder acceptance of the privatization. Two of the seven stakeholders, who were representatives from public interest groups we interviewed, stated that a transparent process can help ensure that the local community's interests are protected in privatizations in addition to providing the public with assurance that the public sector owners have a plan for using the sale or lease proceeds. According to one private-sector airport operator we spoke with, transparency and clarity about how the process will affect airlines and concessionaires can also lead to more bidders and lower transaction costs for the public sector airport owner as well. For example, the Puerto Rico Public-Private Partnership Authority set an established process for privatizing any public asset held by the Commonwealth of Puerto Rico, and that process was followed and, as noted above, made public in the privatization of Luis Munoz Marin.⁸⁶ Additionally, the City of Chicago added, among other things, a Midway Advisory Board and pledged that the City Council would have 30 days to review any

⁸⁵Puerto Rico Public-Private Partnership Authority, *Study of Desirability and Convenience for Luis Munoz Marin International Airport*.

⁸⁶Puerto Rico Public-Private Partnership Authority, *Partnership Report for the Procurement to Acquire a Lease to Finance, Operate, Maintain, and Improve Luis Munoz Marin International Airport* (San Juan, Puerto Rico, July 2012).

potential privatization deal to the requirements for the second Midway privatization effort.⁸⁷

- **Involve all airport stakeholders in the privatization process**—Six stakeholders we interviewed stated that not all airport stakeholders, such as airlines in foreign airport privatizations or airport labor or concessionaires, are consulted or involved in deciding whether to privatize an airport or on the structure of the airport privatization. For example, three airport labor and concessionaire groups we spoke with about the privatization of Luis Munoz Marin stated that they did not receive much information about the privatization of the airport from the Puerto Rico authorities during the process, leading them to oppose privatization as they did not know what was going to happen to their jobs or their concessions if the airport was privatized. In some foreign transactions one stakeholder analyzed, airlines were not consulted for several privatizations and charges to airlines and airline passengers increased. However, as previously discussed, several private-sector airport operators, investors, consultants, academic experts, and former public airport operators stated that airlines had too much say in the APPP privatization process. These stakeholders stated that negotiating with the airlines to secure their approval was the longest part of the privatization process.

Stakeholders Provided Wide Variety of Views and Options for the APPP

Twenty-three of the 42 stakeholders and experts we interviewed offered a range of suggestions to change the APPP, ranging from relatively small changes that FAA could implement, such as increasing FAA involvement earlier in the process, to more substantial changes that would require congressional action, such as reducing or eliminating airline approval to use the proceeds of the privatization for non-airport purposes. The effect that any of these changes may have on either the decision by public airport owners to privatize or on the APPP process itself, however, is unclear. CRS noted that while streamlining the APPP process might make privatization somewhat more attractive, the public sector's gains are unclear and the private sector's gains are limited from privatization under the APPP and major structural changes to the existing U.S. airport-

⁸⁷ The review board consisted of aldermen and representatives from business, non-profits, and labor groups. The committee was to make a recommendation on the privatization process and any potential deal to the Chicago City Council to include an evaluation of the public benefits of the potential deal, the fairness of the process, and an evaluation of the potential deal's fair value.

financing system would be required to significantly increase interest in airport privatization in the U.S.

In contrast, nineteen stakeholders we interviewed had no suggestions on how to change the airport privatization process in the United States. Two stakeholders (one whom did offer suggestions to improve the APPP and one who did not) did not see airport privatization as a solution to their airport funding or efficiency concerns. Representatives from one airline trade organization we interviewed stated that airlines are looking for airports that are cost-efficient while a representative from another airline trade organization viewed privatization as a solution to a non-existent problem. One public sector airport owner also stated that an increase in the federal PFC cap could provide as much capital investment as the amount of private capital that could come with privatization. See appendix III for a full list of the options mentioned by stakeholders we interviewed. Some of the most common recommendations mentioned by stakeholders included:

- **Change the airline approval requirement in the APPP**—Ten stakeholders we interviewed stated that the requirement to gain approval from the airlines serving an airport being privatized should be modified. Two stakeholders cited that this approval process is the longest part of the current privatization process, necessitating consultation with the airlines for any significant changes to the lease agreement. One private-sector airport stakeholder who suggested that this requirement should be changed noted that public-sector airport owners are able to negotiate other commercial deals without airline approval. The stakeholder stated that even absent the airline approval requirement in the APPP, the FAA would still have the authority to regulate aeronautical rates and charges through their AIP grant assurances. In addition, the requirement possibly reduces the value of the deal as airlines have sought concessions to secure their approval. However, outside of these 10 stakeholders, all four of the airline stakeholders we interviewed stated that the airline approval requirement should be kept, as it provides the airlines meaningful input into the privatization deal to ensure balance between the airlines and the private-sector airport operators and is a critical to a successful privatization deal.
- **Reduce uncertainty and increase the clarity of federal rules**—Five public and private sector stakeholders mentioned that the APPP process could be improved by having the FAA more involved earlier in the privatization process, mainly to educate the public sector airport

owner seeking to privatize the airport. As mentioned above, the FAA is responsible for reviewing applications from public sector airport owners looking to privatize through the APPP. However, representatives of an airport consultants' trade group we interviewed noted that without more information during the decision to privatize, public sector airport owners may not have all the information needed prior to going through the APPP process, a lack that may have led some airport owners to withdraw from the program. FAA officials stated that in light of their early APPP experience, they are becoming more proactive with public sector airport owners to let them know what can be expected from the process. One public-sector airport owner we spoke with stated that the Department of Transportation (DOT) and FAA need to communicate more clearly on the criteria used to review the request to waive repayment of federal grants and that they should provide early response on that decision. One private-sector airport investor stated that private-sector investors look for certainty and reduced risk and look to invest in airports in countries that, among other things, have clear regulations. More communication and earlier waiver decisions could reduce uncertainty surrounding the privatization process. FAA officials stated that they strive to provide key decisions in a timely manner based on the information they receive in the APPP applications.

- **Reduce federal involvement in airport privatizations**—Four airport stakeholders we interviewed stated that FAA involvement in airport privatizations could be reduced to encourage more privatizations. One private-sector airport stakeholder stated that the APPP has too many regulations and disincentives for public-sector airport owners to go through the process and that the length of the process serves as a deterrent to private investors who may not want to wait several years to invest their funds and can make investments elsewhere. Two of the four stakeholders mentioned that eliminating the APPP requirements would let the market determine the best deal for the airport. Three of the four stakeholders also stated that an automatic waiver of the requirement to return federal funds from a privatized airport would eliminate the uncertainty of whether the Secretary would grant a waiver during the APPP process. Under these various suggestions, the FAA would still have some degree of oversight because it would still review the transfer of the airport's operating certificate to a qualified operator and have regulatory authority over aeronautical

rates and charges under the AIP grant agreements, but otherwise, the FAA would not have responsibility for approving the sale or lease.⁸⁸

Concluding Observations

Privatization has the potential to provide additional investment in airports, to ease constrained local budgets and to share with the private sector the financial and operational risks of running an airport in today's challenging air travel market. However, the current structure and financing of airports in the United States, in conjunction with the current privatization process, reduce the incentives and value of privatization while increasing costs and risks for both public-sector airport owners and private-sector investors. The result has been a small number of applications and the even smaller number of resulting airport privatizations in the APPP's 18-year existence. The privatization of San Juan's Luis Munoz Marin International Airport demonstrates that privatization can occur in the U.S. if both the public and private sectors see that the benefits outweigh the costs. Meanwhile, instead of privatization under the APPP, many public-sector airport owners have engaged the private sector through a variety of partnerships ranging from management contracts to development agreements to help reduce costs, improve services, and obtain capital investment without transferring airport control. While privatization may be an option for those public-sector airport owners that determine the potential benefits outweigh the costs, the current structure of the U.S. airport system provides for a broad range of private-sector participation making full privatization less likely.

Agency Comments

We provided a draft of this report to DOT for its review and comment. DOT provided comments in an email that emphasized that privatization can in certain circumstances provide financial benefits to the airport sponsor and broader economic development to the surrounding community, if the new operator is willing to make investments in the airport that the public sponsor cannot. DOT also provided technical comments which we incorporated as appropriate.

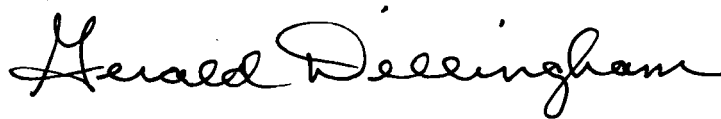
As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the appropriate

⁸⁸FAA rate and fee policy, 61 Fed. Reg. 31994, (June 21, 1996).

congressional committees, the Secretary of Transportation and other interested parties. In addition, the report will be available at no charge on GAO's website at <http://www.gao.gov>.

If you or members of your staff have questions about this report, please contact me at (202) 512-2834 or dillingham@gao.gov. Contact point for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Major contributors to this report are listed in appendix IV.

Sincerely yours,

A handwritten signature in black ink that reads "Gerald Dillingham". The signature is written in a cursive style with a large, stylized "G" and "D".

Gerald L. Dillingham
Director, Physical Infrastructure Issues

List of Addressees

The Honorable John D. Rockefeller IV
Chairman
Committee on Commerce, Science, and Transportation
United States Senate

The Honorable Bill Shuster
Chairman
Committee on Transportation and Infrastructure
House of Representatives

The Honorable Patty Murray
Chairman
The Honorable Susan Collins
Ranking Member
Subcommittee on Transportation, Housing and Urban Development, and
Related Agencies
Committee on Appropriations
United States Senate

The Honorable Frank A. LoBiondo
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The Honorable Rick Larsen
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The Honorable Tom Latham
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House of Representatives

The Honorable Richard Durbin
United States Senate

Appendix I: Objectives, Scope, and Methodology

The objectives of this report were to examine (1) the experience with the APPP since inception; (2) the challenges airport owners and investors face when seeking to privatize U.S. airports within and outside the APPP; (3) the potential effects of airport privatization; and (4) the lessons that can be learned from U.S. and international airports that have been privatized.

To describe the experience with the APPP since its inception in September 1997, we reviewed all 10 airport applications in the FAA's APPP docket and populated a data collection instrument to identify applicants' goals and plans for privatizing their airport as well as rationale for their withdrawal from the pilot program. We used this information to summarize the typical pilot program application process and roles of public-sector airport owners, airlines, private sector investors and operators and the FAA. We also reviewed documents in FAA's dockets for each APPP application and FAA's APPP applications procedures, as well as interviewed FAA officials to determine their participation and that of public airport owners who applied to the APPP from 1997 to the conclusion of our audit work in November 2014. We reviewed the legal history of the APPP including the original legislation creating the program and the 2012 FAA reauthorization law that modified the program. We interviewed airport stakeholders such as city or municipal government airport owners, airport concessionaires, airport labor representatives, local community public-interest and business groups, and air carriers, and private sector airport operators and investors about their roles and responsibilities during their APPP experience. We selected these stakeholders based on our review of the public docket documents for applicants to the APPP, our prior work on airports, and the stakeholders' work on U.S. or foreign airport privatizations. The results of these interviews are not generalizable.

We also interviewed key officials in FAA's headquarters, Great Lakes Region, and Southern Region offices that oversaw the application process for Luis Munoz Marin International Airport (Luis Munoz Marin) in San Juan PR; Chicago Midway International Airport (Midway) in Chicago, IL; and Airglades Airport in Hendry County, FL; as well as Gary-Chicago Airport in Gary, IN; and Branson Airport in Branson, MO; that chose not to apply to the APPP. We conducted site visits to Chicago, Illinois, and San Juan, Puerto Rico, to interview FAA and local community and airport stakeholders for the Midway and the Luis Munoz Marin APPP applications and processes. We selected these two sites as they were the largest airports to have submitted final applications to the APPP, with Midway remaining under public sector operation while San Juan Luis

Munoz Marin transferring to the private sector. We spoke with 42 airport stakeholders (including public sector airport owners; private-sector airport investors, consultants and operators; the FAA; and airlines, among others) and academic and other experts concerning the APPP. We identified these stakeholders from the APPP docket documents and interviews with FAA officials and our prior work on airports and the air transport industry. The results of these interviews are not generalizable.

To determine challenges to airport privatization, we conducted a statutory review of potential challenges or obstacles that could result from federal restrictions on use of airport sales proceeds and airport-purchase financing structures imposed on municipal sponsors and private investors that enter privatization transactions both within and outside the pilot program. We reviewed our 1996 report on issues concerning airport privatization to serve as a baseline for determining how the APPP addressed those issues since then. We conducted interviews with FAA headquarters and regional officials; municipal and public airport authorities that own and operate commercial service airports; airlines; private sector airport operators and investors; private-sector airport privatization consultants, airport operators and investors, academic experts, and bond-rating agencies. For challenges within the FAA pilot program, we conducted semi-structured interviews with pilot program applicants and their consultants and potential private partners to identify challenges, costs, and obstacles throughout the process and how they were addressed. The results of these interviews are not generalizable.

To examine the possible influence of privatization on airport efficiency, we interviewed a variety of knowledgeable stakeholders and also reviewed some academic work that examined this issue. The results of these interviews with knowledgeable stakeholders are not generalizable. To determine the potential impacts of airport privatization on Airport and Airway Trust Fund and on federal tax revenues, we analyzed current AIP rules and regulations and reviewed applicable tax law in addition to interviewing consultants and lawyers who worked for both the public and private sectors in airport privatizations under the APPP. To determine the potential impact on airport labor and concessionaires, we reviewed APPP documentation and its legal requirements and interviewed airport labor representatives and concessionaires in Puerto Rico about their experiences since Luis Munoz Marin was privatized and City of Chicago Department of Aviation officials as to how Midway would have been privatized. For perspectives on challenges and benefits of airport privatization and public-private partnerships outside the FAA pilot program, we interviewed representatives from Branson Airport, the only

privately operated commercial service airport that did not go through the APPP process in the United States and Gary-Chicago Airport, whose public sector owners opted for private management of the airport outside of the APPP process as well. We also interviewed investors and consultants that are active in airport public-private partnerships to get their perspectives on the potential benefits and advantages that offset costs or challenges for partial privatization of commercial service airports in the United States. The results of these interviews are not generalizable.

To identify lessons learned from airport privatization in the United States and countries abroad, we reviewed industry and think-tank reports and articles about airport privatizations and interviewed knowledgeable experts who have participated in airport privatizations around the world. In addition, we reviewed selected airports with similar governance and finance structures as U.S. airports to find the most comparable cases that had privatized in the last 20 years for more information about how these airports were privatized. We selected Frankfurt Airport in Frankfurt, Germany; Vancouver International Airport in Vancouver, Canada; and London Luton Airport in Luton, United Kingdom. We reviewed the United Nation's International Civil Aviation Organization's country reports on airport and air navigation service privatization reports for 25 countries to determine basic elements of airport privatization initiatives around the world as well as ACRP's and CRS's recent reports on airport privatization in the U.S.

Out of the 42 total stakeholders we interviewed (see table 1 below), 31 (airport stakeholders from the FAA, public-sector airport owners, airlines, and private-sector airport owners, operators and consultants) mentioned lessons learned from airport privatization in the United States or abroad.¹ Twenty-three stakeholders and experts out of the 42 interviewed offered suggestions about how to improve the APPP. We interviewed the airports' municipal sponsor, private operator, and representatives from an air carrier and community associations in Chicago and the municipal sponsor, private operator, an air carrier, concessionaires, and a labor and a community group in San Juan to gather information about the privatization process under the pilot program including lessons learned that lead to the success and withdrawal of the applications (respectively).

¹We interviewed FAA staff several times over the course of our engagement and combined their responses as one stakeholder.

In San Juan, we also interviewed the stakeholders about the preliminary results and impacts of the transition from a public to private operator for Luis Munoz Marin. The results of these interviews are not generalizable.

We conducted this performance audit from January 2014 to November 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Table 2: Airport Privatization Stakeholders GAO Interviewed

Federal agencies

Congressional Research Service

Federal Aviation Administration

Academic researchers and third party experts

Jonathan Gifford, George Mason University Center for Transportation Public-Private Partnership Policy

Robert Poole, Reason Foundation

Greg Principato, Former President of Airports Council International - North America

Financial institutions

Moody's Investor Services

Standard & Poor's

Raymond James & Associates

Industry associations

Airlines for America

Association of American Airport Executives

Airport Council International - North America

Airport Consultants Council

International Air Transport Association

Airport owners

Puerto Rico Ports Authority

City of Chicago

Branson Airport LLC

Gary/Chicago International Airport Authority

Port Authority of New York and New Jersey

Private sector airport stakeholders

Aéroports de Paris

**Appendix I: Objectives, Scope, and
Methodology**

Aerostar
AvPorts
ADC & HAS
Kimley-Horn and Associates, Inc.
MacQuarie Infrastructure
Global Infrastructure Partners
Propeller Investments
Leigh Fisher
Vantage Airports
Frasca Consultants
Southwest Airlines
JetBlue Airlines
Highstar Capital
Mayer Brown
William Blair Company
Parsons Brinkerhoff
Other airport stakeholders
Caribbean Airport Facility
Civic Federation of Chicago
Puerto Rico Bankers Association
Puerto Rico Ports Authority Managerial Employees Association
Puerto Rico Public Private Partnership Authority
Trans Ad
United States Public Interest Research Group

Source: GAO|GAO-15-42

Appendix II: Airport Privatization Lessons Learned Offered by Stakeholders Interviewed

Thirty-one airport stakeholders and experts offered lessons learned from prior airport privatizations out of a total of 42 stakeholders and experts interviewed. Some stakeholders and experts offered more than one lesson learned. Eleven stakeholders and experts we interviewed did not offer any lessons learned.

Table 3: Lessons Learned Offered by Stakeholders Interviewed

Lesson learned	Times mentioned
Ensure public sector due diligence and protect the public interest	9
Create a transparent process or a defined schedule	7
Involve all stakeholders in process	6
Pre-planning with airline partners	4
Ensure private sector due diligence	3
Ensure financial capacity of bidder	2
Determining who owns what and what the benefits are	2
Early or good coordination with FAA	2
Obtain public comments and address them	2
Characterize transaction as a public-private partnership not a privatization	2
Ensure public and private incentives are aligned during lease	2
Privatization can happen in the U.S. when price and costs are right for private sector	2
Educate public and private sector about privatization process	1
Do not go out with indicative bids too early in the process	1
Be aware of the costs (financial and political)	1
Determine clear policy goals for privatization	1
Need strong political will to get it done	1
Have more clarity in FAA regulations	1
Write clear, prescriptive request for qualifications/request for proposals	1
Determine who has oversight of public-private partnership before the deal is executed	1
Have a third-party public agency responsible for privatizing the asset	1
Ensure bidders are serious with minimal hurdles to bidding	1
Have one FAA regional point of contact	1
Include bidders earlier in the negotiation process with airlines use agreement	1
Do not look to prior privatization deals too much in structuring another airport privatization deal	1
Private airports should be built outside of the APPP	1

**Appendix II: Airport Privatization Lessons
Learned Offered by Stakeholders Interviewed**

Lesson learned	Times mentioned
Good communication between public and private sectors	1
Long-term lease incentivizes the private sector to invest in airport, even outside the APPP	1
Determine a sound methodology for evaluating airport value	1
Establish better communications and public education process	1
Build in time for public review of agreement	1

Source: GAO analysis of stakeholder interviews. | GAO-15-42

Appendix III: APPP Improvements Mentioned by Stakeholders Interviewed

Twenty-three airport stakeholders and experts offered lessons learned from prior airport privatizations out of a total of 42 stakeholders and experts interviewed. Some stakeholders and experts offered more than improvement to the APPP. The remaining 19 stakeholders and experts we interviewed did not offer any suggestions to improve the APPP.

Table 4: APPP Improvements Suggested by Stakeholders Interviewed

APPP improvement suggested	Times mentioned
Re-examine or change the APPP airline approval requirement	10
Reduce uncertainty/increase clarity in federal rules	5
Leave the APPP airline approval requirement	4
Reduce federal involvement in airport privatizations	4
Require private sector credit-worthiness	2
More FAA involvement up-front in the APPP process, prior to bidder selection	2
Shorten time to complete privatization process	1
Require private sector transparency equal to public sector	1
Require private sector due diligence study prior to application	1
Allow use of AIP funds for due diligence study	1
Have a blueprint for the APPP process	1
Increase transparency of FAA process	1
Require a third-party mediator for dispute resolution	1
Allow more airports to participate in the APPP	1
Introduce a federal aeronautical rate-making methodology	1

Source: GAO analysis of stakeholder interviews. | GAO-15-42

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

Gerald L. Dillingham, (202) 512-2834 or dillinghamg@gao.gov

Staff Acknowledgments

In addition to the contact named above, the following individuals made important contributions to this report Paul Aussendorf, Assistant Director; Amy Abramowitz; Thomas Beall; Leia Dickerson; Mya Dinh, Greg Hanna; David Hooper; Delwen Jones; Jennifer Kamara; Joshua Ormond; and James Wozny.

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