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Issues for Airports in the 2007 FAA Reauthorization

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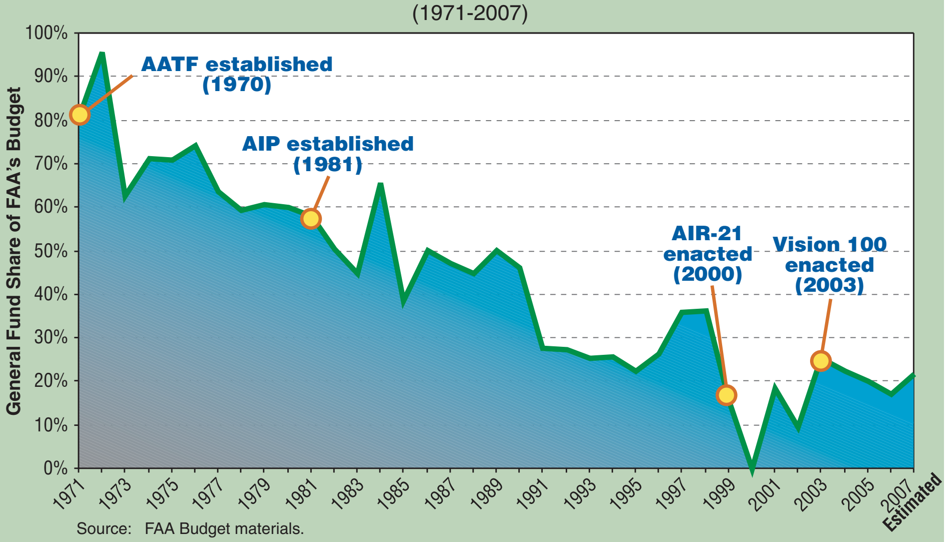
The current authorization for the Federal Aviation Administration (FAA) and its programs expires on September 30, 2007, the end of Federal Fiscal Year 2007 (FFY 2007). *Vision 100 - The Century of Aviation Reauthorization Act* (*Vision 100*), provides the legal authority for FAA operations, as well as a myriad of other federal programs vitally important to aviation and airports. This focus piece is designed to acquaint airport operators with the major issues of the upcoming reauthorization debate and how their resolution will affect airport planning, finance, and federal aviation policy over the next few years. This issue primarily addresses system financing and the major funding priorities of the airport community. A subsequent focus piece will detail the array of policy issues that will be part of the debate.

AUTHORIZATION vs APPROPRIATION

There are two important steps in the federal policymaking process: an authorization, that provides legal authority for the federal government to undertake a program, and an appropriation that provides the dollars to fund programs. The length of an authorization is typically between 3 and 5 years, with Vision 100 running the period between FFY 2004 through FFY 2007. The next authorization bill will run from October 1, 2007 (FFY 2008) to the end of the authorization period. For a program to actually be initiated, operated, and maintained by a federal agency, the authorization must receive an accompanying appropriation for the project for each fiscal year. Confusion often occurs when Congress authorizes a program at a particular level and then either does not provide any funding, or does not appropriate monies to the authorized level. This happened frequently with the Vision 100 authorization.

Any time a federal authorization is set to expire, it is a significant event. However, the expiration of *Vision 100* is especially important due to the uncertainties regarding the long-term financial viability of the Airport and Airway Trust Fund (AATF) and the level of contributions that can be expected to be paid from federal taxpayers into the General Fund. These General Fund contributions derive from the taxes collected by the federal government for overall government obligations while AATF monies come from a variety of aviation-specific taxes and fees. Together, General Fund and AATF revenues fund the FAA's major programs, including FAA Operations, the Facilities and Equipment account (F&E), the Airport Improvement Program (AIP), and the Research, Engineering and Development (R, E&D) program.

Figure 1
General Fund Contribution to FAA Programs
(1971-2007)



Source: FAA Budget materials.

FAA FUNDING: GENERAL FUND SUPPORT

For the last 35 years, General Fund contributions have constituted between 0% and 95% of aviation program funding (see Figure 1). There is no specific rationale or means of determining what the annual contribution by the General Fund to aviation programs will be; instead, it has been driven by perceived FAA needs and the political pressures Congress faces to fund other national priorities, reduce taxes, and otherwise shape national fiscal policy. Although some analysts have argued for a rationale grounded in the importance of aviation to the overall common good (e.g., military flights that are integral to national defense, or gains to the economy realized by non-users of the system), neither Congress nor recent presidential administrations have yet to move in that direction.

In recent years, the General Fund share contributed to aviation programs has been on a steady decline from approximately 70% of overall funding to, most recently, around 20%. By definition, this reduction in General Fund support increases the share of the burden paid by the industry through taxes and fees. As the rate of growth of AATF revenues has slowed (as described below), it—combined with reduced General Fund monies—has also placed downward pressure on overall spending for FAA programs. As industry groups prepare for the 2007 debate on the successor to *Vision 100*, many are calling for a more consistent, reliable, rational, and higher contribution from the General Fund.

FAA FUNDING: THE AIRPORT AND AIRWAY TRUST FUND

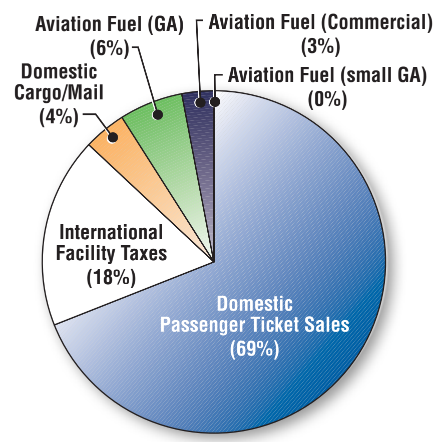
The AATF was established in 1970 to provide a reliable source of capital funding for airport (AIP) and air traffic infrastructure (F&E). The idea was to set aside a pool of money "in trust" that would be available for long-term capital investments. If the capital investments were fully funded, then any residual could be used on an annual basis to defray congressional appropriations for FAA Operations. With the recent pressures on FAA funding, however, AATF revenues have been first used to pay for FAA Operations, including air traffic controllers, other FAA personnel, and a wide variety of non-capital FAA needs. This trend, and the trend toward lower General Fund contributions, is the principal reason Congress has not funded AIP, and especially F&E, at fully authorized levels during the *Vision 100* period.

Figure 2 presents the types and shares of taxes and fees that flow into the AATF, demonstrating that passengers and commercial airlines bear the majority of responsibility for industry fees. Beginning in early 2001, and especially following the terrorist attacks of September 11 later that year, revenues flowing into the AATF slowed significantly. The slowdown would result in the AATF collecting $3 billion to $4 billion less annually than pre-2001 projections for the period between FFY 2002 and FFY 2005. This resulted in a shortfall for FAA programs. This was due to the decline in aviation traffic and the real decline in airfares, the two variables in the passenger ticket taxes that mainly determine the amount of monies collected from system users. While overall traffic has now fully recovered nationally, and airline yields are strengthening, AATF revenue projections are still lagging behind past projections.

CALLS FOR AATF REFORM

Both the Secretary of Transportation and the FAA Administrator have called for reform of the AATF, citing the inadequate and unstable flow of AATF revenue, as well as the difficulty of relying on increased General Fund contributions given competing national priorities for those monies. Among other groups, Airports Council International—North America (ACI-NA) and the American Association of Airport Executives (AAAE) have called for reforms that would stabilize both the General Fund contribution level and resources flowing into the AATF. These reforms would help protect money available for system infrastructure needs, including grants for airports. Other Washington-based interest groups, such as the Air Transport Association (ATA) and its member airlines, have joined the call for reform, focusing on system needs, such as air traffic modernization, as well as reform in the AATF taxes and fees that they posit disproportionately burden the commercial airlines. Groups representing the general aviation community, such as the National Business Aviation Association (NBAA), in contrast, have generally supported the current AATF structure and dispute the ATA claim that commercial airlines pay too high a share, compared to general aviation users, for the use of system resources. In an attempt to establish clarity with future AATF projections, ACI-NA has developed a model of the AATF that documents future challenges in funding system needs if the *Vision 100* funding levels and current taxes are simply extended in their current form in the upcoming reauthorization bill.

Figure 2
Distribution of Aviation Excise Taxes

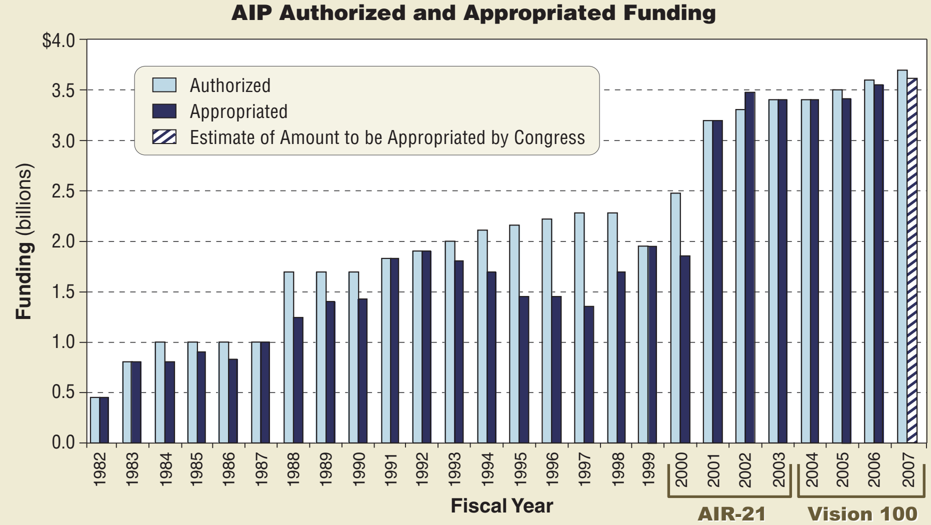


Source: FAA.

FAA ESTIMATED CAPITAL NEEDS

Each reauthorization cycle, the FAA estimates the federal capital needs of the nation's airports. For the period between FFY 2007 through FFY 2011, the FAA believes airports will have $41.2 billion of AIP-eligible infrastructture needs, an increase of four percent since the last estimate.[1] The report, *National Plan of Integrated Airport Systems 2007-2011 (NPIAS),* does not include airport projects that are to be funded by PFCs or by airport bonds even if they are AIP-eligible. Nevertheless, the report traditionally provides a good estimate of how overall airport needs are changing and is used by Congress in its consideration of airport finance priorities.[2]

Figure 3
AIP Authorized and Appropriated Funding



Source: Congressional Budget Office, Jacobs Consultancy.

Figure 4

Airport Hub Types (FAA)

Hub Type	% of System wide Annual Boardings
Large	1% or more
Medium	at least 0.25%, but less than 1%
Small	at least 0.05% but less than 0.25%
Non-hub	more than 10,000 but less than 0.05%
Commercial Service	at least 2,500 and no more than 10,000

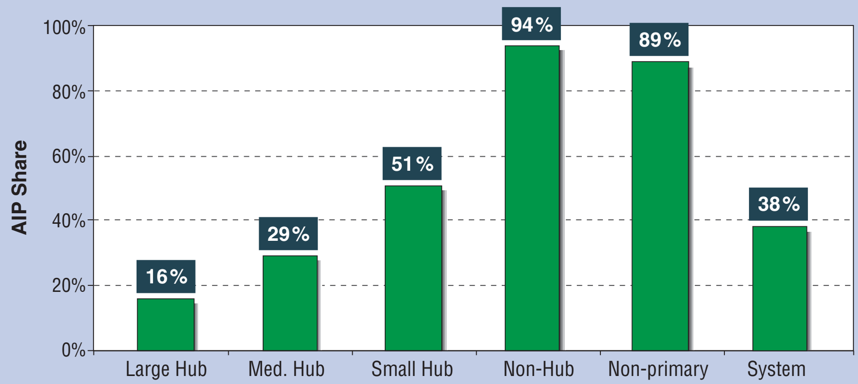
MEETING AIRPORT CAPITAL NEEDS: FEDERAL AIP

Federal sources of money are critical for funding airport infrastructure, but their *relative* importance typically depends on the size of an airport and its ability to generate sources of funds, whether from AIP, passenger facility charges (PFCs), aeronautical and non-aeronautical airport revenues, or retained earnings and non-airport sources.

- *AIP Entitlement Grants*
  The most important source of federal capital for airports is AIP entitlement funds (about 71% of all AIP funds) that are allocated based on an airport's calendar year enplanements (see Figure 3 for historical levels of AIP funding and Figure 4 for FAA airport classifications). As shown on Figure 5, non-hub airports and the so-called commercial service airports rely on federal AIP monies for approximately 94% of their capital programs. On the other end of the spectrum, large-hubs rely on AIP for approximately 16% of their capital programs.[3]

Figure 5

Airport Improvement Program Funding Share of Airport Capital Development Programs



Source: FAA, *Data Package for Stakeholders.*

- *AIP Discretionary Grants*
  Discretionary funds (about 26% of all AIP funds) make up most of the rest of AIP and are available to any airport, based on FAA funding priorities, such as safety and capacity. For many larger airports, discretionary funds can be a significant source of revenue for major capital projects.
- *Small Community Fund/ Administrative Expenses*
  Together, these expenses make up 3% of AIP.

Not surprisingly, smaller airport operators have an especially strong interest in ensuring adequate federal funding, including healthy AATF and General Fund contributions. Without them, AIP funds would be threatened and possibly constrained, imposing a financial challenge to these airport operators that are more dependent on federal dollars. Under *Vision 100,* advocacy by airport operators and their trade associations has generally protected AIP from severe reductions (such as the $950 million reduction from *Vision 100* authorized levels recommended in the President's FFY 2007 budget submitted to Congress).

MEETING AIRPORT CAPITAL NEEDS: LOCAL PFCs

Federally authorized PFCs are a crucial source of local revenue for most commercial service airports. Airport operators may assess PFCs up to a maximum of $4.50 for any originating or connecting flight (no passenger is charged more than two PFCs for a one-way trip). Airport operators use PFCs in two principal ways: as a source to fund capital projects on a pay-as-you-go basis and to back airport bonds.

- *Pay-as-you-go use of PFCs*
  PFCs fund more modest airport projects on a current year basis or are saved over a number of years to fund somewhat larger projects.
- *Leveraging PFCs by issuing bonds*
  Bonds leverage PFCs over a multi-year period, enabling the airport operator to finance large-scale airside and landside projects, including many terminals. Due to leveraging, many airport operators have pledged future PFC collections to the repayment of airport bonds for current projects.

Raising the PFC $4.50 Ceiling

Because PFCs are often tied up to pay debt service, and because the PFC ceiling has not been adjusted for project-cost inflation, during the reauthorization discussions airport operators are expected to seek an increase in the $4.50 ceiling (currently a PFC of between $7.00 and $8.50 is being discussed). PFC users are also expected to offer proposals for streamlining the application and regulatory review process, asserting that this would save project costs and time in completing airport projects, while not sacrificing necessary federal oversight.

PFC Turnbacks

PFCs assessed by operators of medium- and large-hub airports also play a system role: they have the effect of transferring federal AIP support from the larger airports to smaller airports. This is due to federal law that requires medium- and large-hub airport operators to "turnback" to the federal government 50% of their entitlements if they assess a $3.00 PFC and 75% if they assess a $4.00 or $4.50 PFC. These monies are then given to the FAA's Small Airports Fund (87.5%) and to the FAA discretionary account (12.5%). Turnbacks make up a substantial portion of overall entitlements received by general aviation (33%), commercial service and non-hub airports (77%), and small-hub airports (24%).

[1] See NPIAS available at http://www. faa.gov.

[2] Congress uses *ACI-NA's Capital Needs Survey* as well. ACI-NA's version is due out at the beginning of 2007.

[3] See FAA, "Airports Data Package for Stakeholders," September 2, 2005 available at http://www.faa.gov

AIP and the smaller airport operators' reliance on the PFC turnback serves to help unite the airport community around the importance of the PFC program, and the priority to obtain a cost-based increase in the next reauthorization bill.

MEETING AIRPORT CAPITAL NEEDS: AIRPORT REVENUE BONDS

Airport Bonds are a significant source of capital, and are typically backed by airport revenue. These derive from fees assessed on the users of an airport, both aeronautical (e.g., landing fees and gate and ticket counter rentals) and non-aeronautical (e.g., concessions and parking). As with PFCs, airport operators project future revenues that will be collected from these facilities, using bond proceeds to finance projects upfront. While these monies do not require a federal review process and have no absolute ceiling as do PFCs, at a minimum they face review, and at some airports they require approval by the airlines. For that reason, and because airport operators are sensitive to a level of fees that potentially could discourage traffic and occupancy by prospective and current airlines (the costs of debt service are incorporated into an airport's rates and charges), these sources face practical and legal limitations, as well as some federal regulation and oversight. The degree of the federal role depends on whether they are aeronautical (where federal oversight is significant), or non-aeronautical (where airports have more discretion).

TAX STATUS OF AIRPORT BONDS

While U.S. airports are owned and operated by state and local public entities, not all of their bonds are classified as tax-exempt for federal tax purposes. In fact, about two-thirds of airport bonds are deemed "private activity," meaning that the interest paid to bondholders is subject to the Alternative Minimum Tax (AMT). To offset the additional interest costs paid by bondholders, airport issuers must offer interest rates that are between 0.2% and 0.4% (between 20 and 40 basis points) higher. Over the life of a 30-year bond, this can amount to tens of millions of dollars in additional operating costs and reduces the overall financing capacity of the airport. AMT Bonds, because of their tax status, cannot be refinanced—or advanced refunded—like non-AMT Bonds (i.e., those that are fully exempt from federal taxation).[4] In reauthorization, airport operators are expected to argue that publicly owned and operated facilities should be fully exempt from federal taxation, especially for projects eligible for either AIP or PFC funding. Given a political environment where federal monies are likely to face continuing constraints, reforms that permit airport operators to get more out of local sources of funding could be an attractive argument to policymakers.

AIRPORT FINANCE STRATEGIES FOR REAUTHORIZATION

1. *Increase the PFC ceiling and streamline the PFC*
2. *Protect and provide additional funding for AIP*
3. *Make more airport bonds fully tax-exempt*
4. *Reform the General Fund Contribution and the AATF to stabilize federal aviation capital investments*

BIG ISSUES IN PLAY FOR 2007

It is always challenging to predict what the character of the political environment will be as aviation reauthorization approaches. Nevertheless, the long-term growth in aviation traffic, the FAA's financing challenges, the restructuring of airline operations, and developments in the general aviation business mean that this reauthorization could be the most significant in at least a decade. With so many major funding and policy issues "on the table," airport operators should assess what their needs are for the next five years, determine whether or not the agendas of policymakers and industry groups are representing their needs, and decide how they are going to participate in shaping the future of the industry. ■

[4] Over time, interest costs on AMT bonds have been partially offset by "synthetic" means, involving a variety of financial transactions.

JACOBS CONSULTANCY, formerly Leigh Fisher Associates and Sypher, has main offices in the San Francisco area; the Washington, D.C. area; Ottawa, Canada; and London, UK. For over 60 years, we have assisted our clients in achieving their vision and goals. We have extensive practical experience in all of the disciplines necessary for the planning and management of airports, including airfield and airspace analyses, airport management and operation, commercial and concession planning, economics and forecasting, facilities planning and design, federal funding and policy development, financial analysis and planning, financial feasibility and reporting, ground transportation planning, noise and other environmental analyses, privatization, parking planning and analysis, rental car facility development and business planning, security planning and implementation, and simulation and operational analyses.

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