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POLICY BRIEF

Policy Brief No. 4

September 1997

Airport Privatization Pilot Program

by Robert W. Poole, Jr.

Introduction

In October 1996 Congress enacted legislation permitting up to five U.S. airports to be sold or leased to the private sector. Under the Airport Privatization Pilot Program, governments which own commercial and/or general aviation airports may apply to the Federal Aviation Administration (FAA) for waivers from those provisions of federal aviation law which might otherwise forbid the retention of sale or lease proceeds by that government, and from other provisions requiring repayment of previous federal grants or the return of land provided by the federal government.

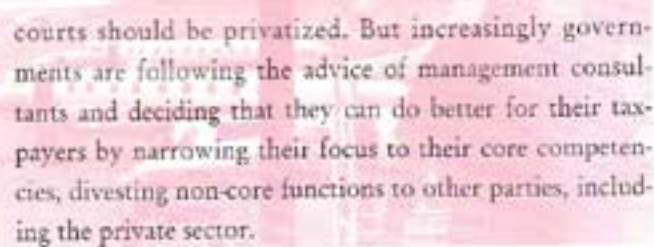
On September 16, 1997 the FAA published in the Federal Register its final guidelines and application procedures for the Pilot Program. Preliminary applications to take part in the program will be accepted by the FAA beginning December 1, 1997—and applications meeting FAA requirements will be accepted on a first-come, first-served basis. Thus, those cities, counties, and states wishing to participate in the program should act with all deliberate speed in order to have a reasonable chance of obtaining one of the five available slots in the Pilot Program.

This Policy Brief explains the potential benefits of privatizing airports, provides a brief overview of airport privatization as it is emerging worldwide, summarizes the provisions of the Pilot Program, and explains how to apply to participate in the Program. An Appendix provides some useful reference material.

Why Privatize Your Airport?

A number of factors lead governments to consider divesting various enterprises. Few would contend that inherently governmental functions such as police or the





courts should be privatized. But increasingly governments are following the advice of management consultants and deciding that they can do better for their taxpayers by narrowing their focus to their core competencies, divesting non-core functions to other parties, including the private sector.

Increasingly, governments are deciding that airports are not core functions. Although municipal electric and gas utilities exist in the United States, most cities have opted not to get into those commercial businesses. Airports, especially air-carrier (commercial) airports, are increasingly being viewed as commercial businesses. As such, they can be operated by private firms on a self-sustaining, profitable basis. A city which has tied up capital in an airport may recover that capital, by selling or leasing the airport to a private operator, and use the proceeds for core government operations.

In recent years, a number of organizations (including the American Association of Airport Executives, the General Accounting Office, the Reason Foundation, and the World Bank) have analyzed airport privatization, both in theory and in practice. Among the potential benefits of the sale or lease of airports are the following:

A. Increased Operating Efficiency

A company running the airport as a business is more likely than a government agency to rethink all aspects of the operation to reduce costs and increase productivity. For example, productivity increased significantly at the three main London airports, following their privatization as BAA in 1987.

One way private firms can achieve greater efficiency is by outsourcing various support services to lower-cost providers, selected competitively. For example, the Burbank Airport (privately managed by Airport Group International) contracts out airport fire and rescue service to a private firm. For a city government to have taken this action might have been a source of political controversy. But it was simply a business decision to the company operating the airport.

B. Improved Customer Amenities

Private firms like AGI and BAA have revolutionized airport retail operations over the past decade at such air-

ports as London's Heathrow and Gatwick, the international terminal at Toronto, and the new terminal at Pittsburgh. Four main principles characterize the new, customer-friendly retail approach: (1) double or triple the amount of space devoted to retail shops, (2) brand-name retailers offering a much wider variety of goods and services, (3) competing providers of many goods and services, and (4) street-level prices rather than the traditional much higher airport prices. Using this new approach, BAA USA has tripled the retail spending per passenger at Pittsburgh's new terminal.

C. Additional Airport Operating Revenues

The old nonprofit, noncommercial approach to airport management often results in rents and other charges set far below market levels and a serious underutilization of the airport's properties. The commercial approach being adopted by private airport operators (and their government-owned but commercially run counterparts in Europe such as Schiphol and Frankfurt) employs modern businesslike approaches to real-estate management, the negotiation of leases and concession arrangements, and the search for higher and better uses for airport land, consistent with airport operations.

This kind of commercial approach can produce a win-win situation. Under a 10-year management contract with BAA USA, Indianapolis is expecting 10-year savings of \$142 million, which will mean that the average charge to airlines per enplaned passenger decreases from \$7.78 to \$5.19 over the 10-year period. Under the particular conditions of the Indianapolis contract, these savings will all accrue to the airlines. But under the conditions permitted by the new Pilot Program, these kinds of savings could be shared among the city, the airlines, and the airport company.

D. Risk Transfer

When major new capital investments are required—e.g., the addition of a new terminal—one of the benefits of privatization is the shift of significant risk from the government to the private airport company. Because large capital projects occur infrequently at a particular airport, the government agency that operates it may not

be highly skilled at project management. Many things can go wrong on a large project—especially cost and schedule overruns. But if the airport is sold or leased to a private firm which operates and expands a number of airports as its regular business, the responsibility for financing and implementing a new terminal or runway becomes that of the experienced private firm. Cost and schedule overruns put the firm's investors—not the city's taxpayers or bondholders—at risk. The private company's need to raise project capital in the financial markets serves as a restraint on choosing "Taj Mahal" projects that may be attractive politically but do not provide a cost-effective solution to the problem at hand.

E. More-Rapid and Less-Costly Development

Because they are far less constrained by cumbersome, multi-phase government procurement regulations, private airport firms can typically use streamlined procedures such as Design-Build to develop new facilities such as airport terminals. For example, Transport Canada had estimated that it would require seven years to develop the new international terminal at Toronto's Pearson International Airport. By privatizing the project to a Canadian/U.S. joint venture, the entire project was completed and in service in just 33 months. And instead of costing C\$1 billion, its total cost was just C\$700 million.

Private firms have strong incentives to build projects quickly and efficiently. BAA has set a target of cutting its real (inflation-adjusted) construction costs by 30 percent by the turn of the century. The private consortium replacing the International Arrivals Building at Kennedy Airport will build a new \$1.2 billion terminal serving 40 airlines and six million annual passengers on the site of the existing obsolete terminal, without disrupting existing airline and passenger operations.

F. Sale or Lease Proceeds

By selling or leasing its airport, a city or state can recover the capital value that it has tied up in the airport—both its physical facilities and the value of its land (whose other uses are precluded)—and use those proceeds for core governmental functions. In addition, when the

airport is sold (and in some kinds of lease transactions), the airport returns to the property tax rolls, increasing the city's assessed valuation and contributing its share to the cost of running local government.

The Global Trend Toward Airport Privatization

Divesting airports to the private sector was unknown until 10 years ago. In 1987 the U.K.'s Thatcher government sold what had been the British Airports Authority via an initial public offering of stock. In 1987, investors paid \$2 billion to acquire the company, renamed BAA; today its market value has grown to \$9.4 billion. Since then, a number of other U.K. airports have been sold, including Belfast, Birmingham and Liverpool. Austria and Denmark sold minority stakes in the Vienna and Copenhagen airports in the early 1990s, but few other airports were privatized over the next several years.

However, 1996–98 is shaping up to be a period of major airport privatization, as summarized in Table 1. While Germany and Italy are selling majority stakes in their larger airports, most other countries are opting to offer long-term (frequently up to 50-year) leases (generally termed "concessions" overseas). In May 1997 Australia held a competition to award 50-year concessions for the first of its 23 commercial airports—Brisbane, Melbourne, and Perth. The winning bidders paid a total of \$2.5 billion for these three airports.

What began 10 years ago as a pioneering departure from tradition in Britain has become a major global trend. By the turn of the century, many of the world's leading airports will be operating as private enterprises (see Table 1 on the next page).

What the Pilot Program Does

Several legal barriers have prevented the sale or long-term lease of airports in the United States—until now. Under the FAA's interpretation of the grant assurances

signed by all airport operators receiving federal Airport Improvement Program (AIP) grants, any proceeds from the sale or lease of a city's airport would be considered "airport revenues" and, as such, could only be used within the airport system and for airport purposes. Thus, a city that sold its airport to a private firm would not be able to use the sale proceed to repave its streets; instead, it would have to give the money back to the firm that had just bought the airport to use for airport purposes. Under those circumstances, few cities had any incentive to sell their airports. In addition, federal grant regulations require that if a facility built in part with federal grants changes ownership, the undepreciated portion of the grant must be repaid to the federal government. Also, the rule about airport revenues being used only on the airport had been interpreted by the FAA to imply that a company buying and owning an airport could not keep some of the airport's net income as its profit.

The Pilot Program grants exemptions to these requirements for up to five airports. The new Section 47134 of Title 49 of the U.S. Code authorizes the Pilot Program. And the FAA's September 16, 1997 Application Procedures spell out how a city, county, airport authority, or state can participate in the program.

Specifically, Section 47134 permits the FAA Administrator to grant exemptions for the sale or lease of an airport if the privatization plan provides for the following:

- The airport will continue to be available for public use in a nondiscriminatory manner;
- The airport's operation will not be interrupted in the event of the private operator's financial difficulties or bankruptcy;
- The private operator will maintain, improve, and modernize the airport;
- Charges to airlines will not increase faster than inflation unless a higher amount is approved by 65 percent of the airlines using the airport;
- Fee increases for general aviation planes will not exceed those for airlines;
- Safety and security will be maintained "at the highest possible levels;"

TABLE 1: AIRPORT SALES AND LONG-TERM LEASES

Country	Airports Affected
Argentina	30 largest
Australia	23 largest Brisbane Melbourne Perth
Austria	Vienna
Bolivia	3 largest
Colombia	5 largest Cartagena Barranquilla
Czech Republic	Karlovy Vary
Denmark	Copenhagen
Germany	Dusseldorf Hamburg
Italy	Milan Naples Rome
Jamaica	2 largest
Mexico	35 largest
Panama	Panama City
Portugal	7 largest
South Africa	9 largest
Switzerland	Zurich
United Kingdom	Aberdeen Belfast Birmingham Bournemouth Cardiff-Wales Coventry Liverpool E. Midlands Edinburgh Glasgow London Gatwick London Heathrow London Stansted Prestwick

Privatization Mode	Status
Long-term lease	Planned late 1997
Long-term lease	Planned 1997-98 Leased May 1997 Leased May 1997 Leased May 1997
Sale of minority	Sold 1992, 1995
Long-term lease	Leased March 1997
Long-term lease	Planned 1996-98 Leased 1996 Leased 1996
Sale of minority	Planned late 1997
Sale of minority	Sold 1994
Sale of 50% Sale of majority	Under way 1997 Likely 1998
Sale of majority	Likely 1998
Sale of majority	Sold 1997
Sale of minority	Sold 1997
Long-term lease	Likely 1998-99
Long-term lease	Planned early 1998
Long-term lease	Planned 1998
Sale	Planned 1998
Sale of minority	Planned 1998
Sale	Planned 1999-2000
Sale	Sold 1987
Sale	Sold 1994
Sale of majority	Sold 1997
Sale of majority	Sold 1996
Sale of majority	Sold 1996
Sale of majority	Sold 1994
Sale of majority	Sold 1989
Sale of majority	Sold 1993
Sale	Sold 1987
Sale	Sold 1987
Sale	Sold 1987
Sale	Sold 1987
Sale	Sold 1987
Sale	Sold 1987
Sale	Sold 1987, 1992

- Noise impacts will be mitigated to the same extent as at a public airport;
- Adverse environmental effects will be mitigated to the same extent as at a public airport;
- Any collective bargaining agreement in effect on the date of sale or lease will not be abrogated by the transaction.

The Pilot Program applies to up to five airports. Congress specified that at least one of these must be a general aviation (GA) airport and that no more than one could be a "large hub" airport (meaning that it handles one percent or more of total U.S. passenger boardings). In implementing the program, the FAA has imposed no further limitations or categories. Thus, beyond the one "slot" reserved for a GA airport, the other four could be any combination of GA, non-hub, small-hub, medium-hub, or large-hub, provided that only one of these other four could be a large hub. Thus, in principle, all five slots could go to GA airports, or at the other extreme, four of the five could go to medium and large hubs. For GA airports, the mode of privatization may be either sale or lease. For air-carrier airports, only a lease is permitted.

The FAA intends to follow a first-come, first-served procedure. Beginning December 1, 1997 it will accept preliminary applications from jurisdictions hoping to privatize an airport under their control. The first five applications that meet the basic criteria will be "accepted for review." If more than five acceptable applications are received, the later ones will be put on a stand-by list.

Once a preliminary application has been accepted for one of the five slots, as noted above, the applicant may then issue its request for proposals (RFP), select a private operator, and negotiate an agreement. Having done that, it must then submit a final application, which is subject to a 60-day comment period.

Should an accepted application be withdrawn or its subsequent final application be judged unacceptable, applicants from the stand-by list will be notified, in the order that their preliminary applications were received, that they can proceed to the RFP process/final application stage.



How to Take Part in the Pilot Program

A. Timing

If your jurisdiction wishes to be considered for the Pilot Program, time is of the essence. Since the first five preliminary applications that meet the basic requirements will be given the five slots initially, and since applications can be submitted as early as December 1, 1997, it is essential to file a preliminary application by that date in order to have a reasonable chance of being accepted.

This need for speed is especially acute, given that two airports will qualify for an early-application exemption because of having issued their RFPs prior to the FAA's promulgation of the final rules. Allegheny County, PA has already held its competition and selected the private operator (Comarco) for its general aviation airport. Assuming its final application is accepted by the FAA, the one slot that must go to a GA airport will then have been filled. New York State issued its RFP for the long-term lease of Stewart Airport on June 19, and its deadline for receiving proposals is October 17; it also qualifies for an early-filing exemption.

Thus, assuming that both the Allegheny County and Stewart applications are accepted by the FAA on its first-come, first-served basis, there will remain only three slots as of the initial December 1, 1997 application date.

B. Preliminary Application

According to the FAA's Sept. 16 Application Procedures, a preliminary application should consist of:

- Description of parties to the transaction (to the extent known);
- Summary of the objectives of the planned privatization;
- Description of the process and a realistic timetable for selecting a private operator and completing the transfer of the airport;
- Description of the airport property to be included in the transfer;
- Airport financial statements for the last two reporting periods;

- Completed request for proposals (RFP) to be issued following approval of the preliminary application.

C. Final Application

The final application must be filed after the government airport owner has selected a private operator and reached sufficient agreement on the terms of the transaction to describe them in the application.

- *Part I: Parties to the Transaction*—including the current airport owner, the private firm or consortium members (and their citizenship), and a statement of the current owner's authority to sell or lease the airport.
- *Part II: Airport Property*—including a history of the acquisition of various parcels, identifying those donated by the federal government or purchased with federal funds.
- *Part III: Terms of the Transfer*—including both non-financial and financial provisions, copies of all documents executed (or to be executed), and provisions for ensuring future compliance with grant assurances;
- *Part IV: Qualifications of the Private Operator*—including prior airport management and operations experience, financial statements, and compliance plans.
- *Part V: Requests for Exemption*—covering the use of sale or lease proceeds, repayment of federal grants or return of federal lands, and compensation of the private operator.
- *Part VI: Certification of Air Carrier Approval*—documenting airline approvals, as required by Sec. 47134.
- *Part VII: Airport Operation and Development*—how the private operator plans to operate, maintain, and improve the airport and comply with the provisions of Sec. 47134 and the various grant assurances;
- *Part VIII: Periodic Audits*—agreement to this provision.

Both types of application are to be delivered to the following:

Susan L. Kurland

Associate Administrator for Airports, ARP-1
Room 600 East, Federal Aviation Administration
800 Independence Avenue, SW
Washington, DC 20591

Appendix

The following information may be useful in preparing an application and participating in the Airport Privatization Pilot Program.

A. Airport Privatization Consultants

These are among the handful of firms with actual experience assessing airport privatization.

Apogee Research

4350 East West Highway, #600

Bethesda, MD 20814

Contact: Richard Mudge, 301-652-8444

Frasca and Associates

45 Rockefeller Plaza, #2000

New York, NY 10111

Contact: Doreen Frasca, 212-332-3450

Infrastructure Management Group

4733 Bethesda Ave., #600

Bethesda, MD 20814

Contact: Steve Steckler, 301-907-2900

Nossaman, Guthner, Knox & Elliott

445 S. Figueroa St., 31st Floor

Los Angeles, CA 90071

Contact: Karen Hedlund, 213-612-7854

Thompson Consultants International

21031 Ventura Blvd., #703

Woodland Hills, CA 91364

Contact: Robert Aaronson, 818-409-7502

B. Airport Owner/Operators

Airport Group International

330 N. Brand Blvd., #300

Glendale, CA 91203

Contact: Patrick Cowell, 818-409-7502

American Port Services, Aviation Management Group

90 Moonachie Ave.

Teterboro, NJ 07608

Contact: John Harden, 201-288-5218

BAA, USA

45240 Business Ct., #225

Sterling, VA 20166

Contact: Michael Bell, 703-708-7283

Comarco Airport Services

1202 26th Ave., NW

Gig Harbor, WA 98335

Contact: Richard Loomis, 253-853-5847

D.M. Airport Developers

Morristown Municipal Airport

8 Airport Road

Morristown, NJ 07960

Contact: Robert Bogan, 201-538-6400

LCOR/Schiphol USA

245 Park Ave., 25th Floor

New York, NY 10167

Contact: David Sigman, 212-972-5510

Ogden Aviation

Two Pennsylvania Plaza

New York, NY 10121

Contact: David Watson, 212-868-6957

C. References on Airport Privatization

General Accounting Office, "Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports," GAO/RCED-97-3, Washington, DC: Government Printing Office, November 1996.

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Rigas Doganis, *The Airport Business*, London: Routledge, 1992.

Norman Ashford and Clifton A. Moore, *Airport Finance*, New York: Reinhold, 1992.

Anil Kapur, "Airport Infrastructure: The Emerging Role of the Private Sector," Technical Paper No. 313, Washington, DC: World Bank, 1995.

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About the Author



Robert W. Poole, Jr. is a founder and president of the Reason Foundation, and is a nationally known expert on transportation policy and privatization. Mr. Poole was one of the first to propose privatization of the air traffic control system, and his work in this field has helped shape proposals for an ATC corporation. He holds two engineering degrees from MIT and has previous experience in the aerospace industry.



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