

GUIDELINES FOR AIRPORT PRIVATIZATION

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EXECUTIVE SUMMARY

Increasingly, airports are being viewed as enterprises, rather than as public services which are expected, at best, to break even. Around the world, governments in both developed and developing countries are turning to the private sector for airport management and development. Municipal and state governments in this country can use the private sector to improve airport operations in several ways.

For existing airports, the simplest form of privatization is contracting out management of the airport on a relatively short-term basis. Larger economic benefits can generally be obtained via a long-term lease or sale of the airport, increasingly common overseas. To create new airport facilities (or entirely new airports), the private sector can be granted either a long-term or perpetual franchise to finance, design, own, and operate those facilities. These techniques can also be used to convert military bases to commercial airports.

Federal airport grant (AIP) funds for capital investment projects can be used at all types of privatized airports, but so-called entitlement grants (based on passenger or cargo volume) are only available if government retains underlying ownership of the airport (which still permits management contracting or long-term leases). Tax-exempt bonds may remain in place when an airport is privatized, and in some cases tax-exempt financing can be used for new airport privatization projects.

The benefits of a more entrepreneurial approach to airport management include increased operating efficiency, increased airport revenues, improved airport amenities, possible new revenue streams for state and local governments, and reduced risk of developing uneconomic (white-elephant) projects. Airlines, passengers, private-plane owners, and taxpayers can all benefit from this new approach to airport management.

I. INTRODUCTION

Since 1987 airport privatization has become a worldwide trend. As of early 1994, privatizing airports was on the agenda of more than 50 countries. In developed countries, the general pattern is for the government to sell all or a partial interest in existing airports or airport authorities. In developing countries, where the principal

need is major expansion and modernization, the usual pattern is for government to use a long-term franchise to have the private sector finance and develop new terminals or entire new airports.

A major factor in the growing interest in airport privatization is government fiscal stress. Developing countries often lack the resources to develop new airport capacity, so they turn to private capital and expertise to get the job done. Governments in developed countries increasingly view airports both as assets and as businesses. A commercial airport is an asset which often fails to produce a commercial rate of return, as operated by government. And as “reinventing government” becomes the guiding philosophy, airports are often seen as non-core functions that can better be managed as businesses, by a private-sector business enterprise.

In part, the move to airport privatization reflects a changed paradigm of what an airport is supposed to be. The traditional paradigm views an airport as essentially a public service whose objective ought to be simply to enable aircraft and their users to arrive and depart while just covering its costs. The airport-as-enterprise paradigm views an airport as an entrepreneurial business, whose objective is to identify and meet the needs of a diverse clientele: not only airlines and private pilots but passengers, meeters-and-greeters, airport staff, airport neighbors, and airport tenants, among others.¹

Airport privatization is much further along overseas than in the United States. Developed countries generally seek to reduce or eliminate their need to invest scarce resources in airports, which can be commercially financed and operated. Developing countries seek world-class expertise, as well as capital, to ensure modern and efficient airports. Airport sales have taken place in four countries, and another seven have announced plans to sell major airports (with the issue under study in eight more). Franchises for new airport capacity projects are under way in 17 countries and under study in 14 others.

In this country, the principal factor leading to interest in airport privatization is the growing trend toward reinventing government, seeking to replace monopoly government agencies with the competitive forces of the private sector. All U.S. air-carrier airports are owned by governments, and less than a dozen are currently leased or managed by private firms. However, since 1989 public officials in a number of cities have proposed the sale or lease of air-carrier airports, including Atlanta, Baltimore, Boston, Indianapolis, Los Angeles, New York, Philadelphia, Rochester, San Francisco, Syracuse, and Worcester. A number of jurisdictions are considering contracting out the management of general-aviation (GA) airports, including DuPage, Illinois; the state of Rhode Island, and San Diego County, California.

The purpose of this guide is to explain how airport privatization applies in the U.S. context, so that public officials can consider their options for ensuring high-quality airport services.

II. PRIVATIZATION MODES

A. Existing Airports

There are three principal alternatives for making use of privatization in the context of an existing airport. In order of increasing reliance on the private sector, they are: a) contract management; b) long-term lease; and c) sale.

1. *Contract Management*

Many types of municipal facilities are being turned over to private contractors on relatively short-term (five years or less) management contracts. Convention centers, data-processing centers, golf courses, jails, sports arenas, and wastewater plants are among the facilities now routinely contracted out by city, county, and

¹ Rigas Doganis, *The Airport Business*, New York: Routledge, 1992.

sometimes state governments. Governments use the competitive process to stimulate greater efficiency in the operation of these facilities, since a firm must rethink the way it does business in order to be competitive in winning an operating contract.

Typically, in a facility management contract, the operating budget is proposed by the contractor and approved by the government; funds needed for budgeted items are appropriated by the government and passed through to the contractor. Fees and charges are paid by users to the government agency, not to the contractor. The contractor receives a management fee from the government agency, which may be based in part on the contractor's performance. The facility's employees and managers work for the contractor, not the government.

Contract management can be used for airports of all sizes and economic conditions, though it is generally most applicable where an airport has been losing money. If an airport is inherently unprofitable (i.e. its costs are very much more than its current and likely future revenue potential), the motivation for contract management is usually to reduce costs and increase revenues, thereby reducing the extent of the airport's deficit. A nearly break even airport can potentially become profitable under contract management.

A number of U.S. airports are operated by contractors. Table 1 lists the four air-carrier airports under contract management as of mid-1994. Also listed are a number of general-aviation airports also managed by contractors, including the five general-aviation airports in Los Angeles County.

2. *Long-Term Lease*

A long-term lease is quite different from a management contract. Generally, a lease is used in preference to a contract where significant airport development is anticipated. The aim is to shift a significant portion of the risk of development away from the taxpayers and to the private-sector lessee. The term of the lease is often related to the length of time needed by the private operator to recover its investment in new facilities. A lease arrangement transfers the principal responsibility for airport operations and development to the private lessee. Hence, unlike the management-contract case, in a lease situation airport users pay fees and charges directly to the lessee, and the lessee must cover its operating and capital costs out of those revenues (and hope to have enough money left over to show a profit).

The typical lease agreement provides for a lease payment to the government based, in part, on a percentage of the airport's gross revenue. This gives the government an incentive to work cooperatively with the lessee, since the government will share in the proceeds. But this arrangement also gives the lessee an incentive to minimize costs, so that it can maximize the difference between gross revenue and costs. And since the lessee is responsible for capital investment in the airport, it will have strong incentives to add only that amount of runway or terminal capacity that will produce an acceptable return on its investment.

Table 1

U.S. Airports Managed by Private Contractors	
Airport	Contractor
Air-Carrier Airports	
Albany, NY	Lockheed Air Terminal
Burbank, CA	Lockheed Air Terminal
Stewart, NY	Lockheed Air Terminal
White Plains/Westchester Co., NY	Johnson Controls World Series
General Aviation (GA) Airports	
Alliance Airport, Fort Worth, TX	Pinnacle Air Services
Brackett Field, LaVerne, CA	COMARCO, Inc.

Capital City Airport, Fairview, PA	Johnson Controls World Services
Compton Airport, Compton, CA	COMARCO, Inc.
Danielson Airport, Killingly, CT	Executive Air Service
El Monte Airport, El Monte, CA	COMARCO, Inc.
Peru Municipal Airport, Peru, IN	Miami County Air Services
Fox Airfield, Lancaster, CA	COMARCO, Inc.
Republic Airport, E. Farmingdale, NY	Johnson Controls World Services
Whiteman Airport, Pacoima, CA	COMARCO, Inc.

Several small air-carrier and large general-aviation airports in the United States are currently leased to private firms, as noted in Table 2. A number of other airports have been leased by municipal governments to independent public authorities; a principal example is the lease by the cities of New York and Newark of Kennedy, LaGuardia, and Newark airports to the Port Authority of New York and New Jersey.

Table 2

U.S. Airports Leased to Private Sector		
Airport	Lessee	Operator
Atlantic City, NJ	Johnson Controls World Services	Johnson Controls World Services
Bader Field, NJ	Johnson Controls World Services	Johnson Controls World Services
Morristown, NJ	D.M. Airport Developers	D.M. Airport Developers
Rickenbacker, OH	Turner Construction	Lockheed Air Terminal
Teterboro, NJ	Johnson Controls World Services	Johnson Controls World Services

3. *Sale*

Worldwide, the most common mode of airport privatization is the sale of either a part-interest or the entire airport. Full divestiture (sale) is the mode of choice when the airport is profitable but may not be maximizing its entrepreneurial possibilities under government ownership and management. Governments generally sell entire airports as part of an overall program of divesting themselves of noncore businesses, using the proceeds either to reduce outstanding debt or for investment in other needed infrastructure. This was the motivation for the British government's 1987 sale of the British Airports Authority and the planned sale of the airports belonging to Australia's Federal Airports Corporation.

In some cases, governments sell only a majority interest, retaining some fraction of ownership and therefore a direct voice in airport management. Liverpool, England sold a 76-percent interest in its airport to a single strategic investor, British Aerospace. Several other British cities are planning similar sales of majority interests.

Some other countries are thus far selling only minority interests. Austria sold 27 percent of Vienna International in 1992 and plans to sell another 18 percent in 1994; the proceeds are being used for airport expansion. Denmark sold 25 percent of the Copenhagen Airport in 1994, and airport authorities in several other European countries are considering similar sales of minority stakes. Table 3 summarizes the status of airport sales worldwide as of mid-1994.

Table 3

Airport Sales Worldwide

Country	Airport/City	Type	Status
Current Airport Sales Activity			
Argentina	Buenos Aires	Sale or lease	Planned
Austria	Vienna	Minority (27%)	Occurred
	Vienna	Minority (18%)	Planned
Australia	Federal Airports Corp.-23 airports	Divestiture	Planned
Czech Republic	Pardubice	Divestiture	Occurred
Denmark	Copenhagen	Minority (25%)	Occurred
Italy	Rome	Divestiture	Planned
	Milan	Divestiture	Planned
Malaysia	Airports Corp.	Divestiture	Planned
New Zealand	Auckland	Divestiture	Planned
Panama	Commercial airports	Sale or Lease	Planned
Peru	Lima	Divestiture	Planned
United Kingdom	BAA (7 airports)	Divestiture	Occurred
	Liverpool	Majority	Occurred
	East Midlands	Divestiture	Occurred
	Prestwick	Re-sold	Occurred
	Belfast	Divestiture	Occurred
	Birmingham	Majority	Planned
	24 local airports	Majority	Planned
Airport Sale Proposals Under Study			
Belgium	Brussels Airport Terminal Corp.	Divestiture	
France	Aeroports de Paris	Minority	
Germany	Berlin Brandenburg Airport Hold.	Divestiture	
	Dusseldorf airport	Divestiture	
	Cologne/Bonn airport	Divestiture	
Ireland	Aer Rianta (3 airports)	Divestiture	
New Zealand	Christchurch airport	Divestiture	
	Wellington airport	Divestiture	
Philippines	Manila Int'l Airport Authority	Divestiture	
Russia	70 Aeroflot airports	Minority	
Spain	Aeropuertos (5 airports)	Partial	

Thus far, although a number of U.S. cities have considered the idea of selling their airport, none has actually attempted to do so.

B. New Airport Capacity

New airport capacity may be developed privately in two ways. The more conventional is via the government granting of a long-term franchise (called a “concession” in most other countries), at the end of which the airport (or terminal) reverts to government ownership. This type of transaction (which sometimes involves some financial participation by the government) is a kind of public-private partnership. The other approach is for the private sector to develop an airport entirely on its own, subject only to the planning permissions required (airspace approval by the national aviation authority, local land-use regulations, etc.). In effect, the airport company has what amounts to a perpetual franchise, though there may not be an actual agreement to that effect (any more than there is for an investor-owned steel mill).

1. Long-Term Franchise (BOT or LDO)

Around the world, long-term franchises for infrastructure facilities are usually referred to as BOT projects, because under this type of contractual agreement the private sector builds, operates, and eventually transfers to government the facility in question. When a lease of the underlying land is involved, this type of arrangement is sometimes called Lease-Develop-Operate (LDO); in this case the “transfer” back to government is implicit, since the lease has a fixed number of years.

The BOT approach is widely used for several reasons. First, it taps into a different pool of capital than is normally available for public infrastructure projects, thereby expanding the range of potential funding sources. Second, private consortia are often able to design and build large facilities in significantly less time than is possible via traditional government procurement methods. Third, both the up-front cost and the operating costs may be lower in a facility that is designed, built, and operated by a single team interested in long-term profitability. Fourth, BOT is a way of shifting many of the risks of project development from the public sector to the private sector.

For these reasons, airport BOT projects have proliferated in recent years. As of early 1994, there were 15 airport BOT terminal or runway projects under way worldwide, and another five projects to develop entire new airports. In addition, another 18 such projects were under study.

No outright airport BOT project has yet occurred in the United States, but Transport Canada used this process to develop the successful international terminal (Terminal 3) at Toronto (as will be discussed in the next section). Many U.S. airports have used something resembling an LDO process to develop new terminals sponsored by either one or a group of airlines, which gain exclusive control of the gates in that terminal. But this type of project raises important competition and access issues that do not arise when the developer/operator is an independent third party which relates to all airlines equally as users (as is the case with BOT terminal projects worldwide).

2. Perpetual Franchise

The number of fully private air-carrier airports (as opposed to small general-aviation fields) is quite small. Among those currently in operation are the London City Airport (a short/medium-haul airport in the Docklands area near the financial district), the Freeport airport on Grand Bahama island in the Caribbean, and the Punta Cana airport serving a resort area in the Dominican Republic. Hawaiian Airlines built and operated a small commercial airport in West Maui, HI in the 1980s, but turned it over to the state as unprofitable several years later.

Several entrepreneurial private airport proposals have been made in the United States, several of them as potential “wayports”—freestanding hub airports aimed primarily at transferring passengers from one flight to another (and therefore not linked to a city's origin/destination market). One of the best-known is the

proposed Aeroplex, planned to occupy 22,500 acres in northwest Martin County, on the east coast of Florida. Its developer received airspace clearance from the Federal Aviation Administration in 1991, but as of 1994 development had not begun.

C. Military Base Conversions

Over 100 major military bases are expected to be closed during the 1990s. Many of these are airfields, and quite a few are in or near urban areas.

The general procedure for federal disposal of unneeded bases is that if no other federal agency needs the property, the local government has first claim on it; under certain conditions, the municipality may be able to obtain it at no charge. In the case of air fields, if the Federal Aviation Administration recommends the site for airport use, the property may be given to the local government for that purpose. Without such a recommendation, the municipality may buy the base or arrange for a private firm to purchase it.

A number of military bases have been or are being converted to civilian airport use. Orlando International Airport is the former Strategic Air Command McCoy Air Force Base, converted in 1974. In New Hampshire, the former Pease AFB became a civilian airport, Pease International Tradeport, in 1991. Scott AFB, 15 miles east of St. Louis, is becoming Mid-America Airport. And in Austin, Texas, officials abandoned a greenfield site for the city's new airport when Bergstrom AFB became available; the base is now being redeveloped as the replacement for Austin's outmoded air-carrier airport.

The long-term franchise mode of privatization is the one most applicable to converting a military airfield to a civilian airport. Instead of attempting the complex task of developing, financing, and managing the airport project itself, the base-redevelopment authority can seek competitive proposals from private-sector consortia. In this way, not only can greater professional expertise be brought to bear, but much of the risk involved in new-airport development can be shifted from taxpayers to investors.

III. POTENTIAL BENEFITS OF AIRPORT PRIVATIZATION

A. Increased Operating Efficiency

One of the most common benefits of substituting a private operator for a government department is greater efficiency in operations. In part this is due to the different incentives at work in the two sectors. Private-sector managers are generally evaluated and compensated in part based on the economic performance of the enterprise; this is very seldom the case in the public sector. Second, the public sector is hampered by such constraints as civil service (which makes it difficult to fire incompetent staff or to reward outstanding performance), cumbersome government procurement regulations (which stretch out the time and increase the cost of purchasing supplies and equipment), and micromanagement from higher levels (either departmental or political).

The private sector may also benefit from economies of scale. A firm that owns and/or operates multiple airports may be able to purchase supplies in bulk, operate centralized accounting, personnel, and other support services to serve all the airports, and take advantage of other economic benefits of larger size.

In addition, the private sector is likely to be less constrained and more willing to contract out functions that can be performed more cost-effectively by other firms. For example, airport fire and rescue service at privately managed Burbank (CA) Airport is contracted out to a private firm. Thus, the single decision to privatize the airport (via management contract, lease, or sale) can serve to depoliticize a potential host of smaller-scale contracting-out decisions, each of which might have involved a political wrangle if it had to be made by a government department.

B. Additional Operating Revenues

It is increasingly being recognized that airports are economic enterprises able to generate more kinds and larger amounts of revenue than traditionally imagined. For smaller, currently unprofitable airports, privatization offers the potential of turning a loss-maker into a profit center. For larger airports which may already be operating in the black, the greater revenue potential under private management can lead to increased returns to the current governmental owner, either via lease payments or sale proceeds.

For general-aviation airports, increased revenues may be derived from instituting landing fees (if none exist), better enforcement of fee payment, encouraging fixed-base operators (FBOs) to develop expanded offerings of goods and services (a percentage of whose proceeds flow to the airport-management company), and more intensively developing airport real estate.

For air-carrier airports, the revenue opportunities are even greater. In some cases, landing fees and/or rental charges may be out of date and below market; likewise for current agreements with concessionaires. Perhaps more important, a privatized airport firm will typically adopt a more expansive retail approach involving a much broader array of goods and services aimed not only at passengers but also at airport and airline employees and airport neighbors. New business opportunities also include providing business services, conference facilities, hotel accommodations (both short-term and longer-term), as well as more intensively developing airport real estate.

It is sometimes noted that there is nothing in the preceding list that is uniquely known to the private sector, which is correct. However, most of these activities require specialized knowledge and an entrepreneurial corporate culture which may not be present in the public sector. There is a higher risk of failure in seeking to convert civil servants into entrepreneurs than in hiring genuine entrepreneurs to do these things. In addition, the competitive process may well generate innovative new ideas for cutting costs or increasing revenues; ideas which would not otherwise have been brought to bear.

C. Improved Customer Amenities

The most dramatic difference which privatization can bring about is a new approach to airport retail activities. Air travelers who have used London's Heathrow or Gatwick airports (privatized via sale in 1987), the new international Terminal 3 at Toronto (developed via BOT/LDO and opened in 1991), or the new Pittsburgh terminal (whose concessions are managed privately by BAA under a 15-year lease) will have experienced airport retail that differs dramatically from other U.S. airports in three respects: 1) the amount of retail space is several times as much as in other terminals of comparable size; 2) the retailers include numerous national and international brand-name outlets; and 3) the prices charged are not high "airport prices" but are the same as one would find in the local shopping mall.

The new privatized retail approach produces a situation in which all parties are better off. Air travelers like the lower prices and greater variety of goods and services, as proven by per-passenger sales two to three times higher than in traditional terminals. The airport operator is happy, because the higher sales volume produces higher net revenues. And the airlines are happy because concession revenues cover a higher fraction of total airport costs.

D. Reduced Risk of White Elephants

A principal reason why the World Bank is now urging privatization of major infrastructure (including airports) in developing countries is to minimize the risk of unwise investment, leading to "white elephant" projects which cost several times what they can generate in revenues. In this country, airlines have grown weary of being faced with grandiose plans for architectural monuments (often referred to as Taj Mahals) posing as new airport terminals. Recent cases in point include the (now-canceled) JFK 2000 project to build a new central terminal at New York's Kennedy International airport, the large new terminal at Washington National airport, and the very costly new Denver International airport.

How and why does privatization make a difference in new-project development? Privatization of airport capital project development (whether by sale, long-term lease, or BOT) shifts many of the risks from the taxpayers to private investors. This, in turn, forces a high degree of “due diligence” in reviewing the design and cost of the project, and especially an insistence on “investment-grade” traffic and revenue forecasts. Privatization helps to ensure that project decisions are made on economic and financial grounds, not on political grounds.

E. Lease or Sale Proceeds

Under contract management, a city or county may be able to reduce or eliminate an airport's operating loss, thereby ending a drain on the taxpayers. But this type of short-term privatization may not produce net revenue for the municipality. That is because federal airport grant legislation makes it illegal for a city to “divert airport revenue” to municipal coffers. All revenues generated by the airport must be used solely for airport purposes, if the airport is to retain eligibility for federal grants.

The only legal way around this restriction is for the municipality to cease being the airport operator. By selling or leasing the airport, the city or county can recover its investment of land (and capital, if any) in the airport, via the lease payments or sale proceeds. The private airport lessee or owner may choose to remain eligible for airport grants, working out its fee schedules and payment arrangements so as to obtain FAA approval, or it may opt to forego federal grants and operate free of FAA economic restrictions. (In the latter case, it may have to pay back the depreciated value of the facilities purchased with the grants.)

The legal aspects of airport sale and lease arrangements are discussed below in Section V.

IV. PROJECT PROFILES

A. Air Carrier Airport/Contract Management (Westchester)

The White Plains/Westchester County Airport is an 800-acre facility surrounded by affluent suburbs and office parks. In addition to scheduled airline service by four major airlines and several commuter carriers, the airport is the home base for numerous corporate jets and turboprops. Activist anti-noise groups made up of affluent homeowners have succeeded, via litigation in limiting the extent of growth in airline passengers over the years.

Turned over to Westchester County by the federal government after World War II, the airport was operated by the airport's fuel supplier for 30 years. In 1977, faced with large operating losses (up to \$250,000/year) at the airport, the county government decided to bid out airport management on a five-year contract basis. Pan Am World Services won the initial contract, and it and its successor company, Johnson Controls World Services, have won renewals every five years since then.

Under contract management, the airport has become solidly profitable, with net income of up to \$3 million per year. The company has achieved these gains by reducing operating expenses (e.g., by cross-training personnel so that fewer people are required), increasing revenues (e.g., by renegotiating ground leases to market levels and instituting paid parking in 1981), and fostering real-estate development. For example, there are now five fixed-base operators (FBOs) compared with three in 1977, as well as additional hangars and related facilities. Despite community-imposed growth limits, major airlines have been attracted to Westchester, compared with the mostly commuter airlines that provided service prior to 1977.

The transition to contract operation was relatively smooth. The county requested the company to offer jobs to all the current airport employees, and all but two accepted such offers.

After many years of political wrangling, a badly needed new terminal building is under construction and set for opening in the summer of 1995, funded by county-issued bonds. A parking structure and service building opened in summer 1994.

The county is pleased with contract management because it insulates public officials from community complaints. Though the county retains all policy-making authority, it can cite and rely on the company's professional advice, thereby depoliticizing many decisions. In addition, of course, the airport's former operating loss has been turned into an operating profit.

B. General Aviation Airport/Concession Management (L.A. County)

Between 1958 and 1970 Los Angeles County acquired five general-aviation airports which their developers were unable or unwilling to maintain. Due to concerns about high operating costs and net low revenues, the county decided in 1990 to contract out these airports as a group. What evolved was a hybrid between contract management and a long-term lease. The 20-year agreement (with two five-year extension options) does not grant the firm a leasehold interest, but it operates financially like a long-term lease rather than a management contract. In other words, users and tenants pay fees to the contractor, out of which the contractor must pay all operating expenses and turn over a guaranteed minimum annual amount to the county.

Prior to the award of the contract to COMARCO, there was strong opposition from GA pilots, airport employees, and some airport tenants. By the contract's second anniversary, privatization had "gained acceptance by most pilots and proved worth celebrating for some," according to a local newspaper account.² Board of Supervisors chairman Ed Edelman, who had voted against the contract in January 1991, wrote a letter of endorsement in January 1993, praising the success of the arrangement.

Financially, during the first two years, COMARCO paid the county \$2.7 million per year, compared to the County's net income of \$2.2 million when it operated the airports itself. The increase was made possible by improved marketing of airport facilities, reduced operating costs, and a computerized revenue control system. Despite opponents' fears, there were no increases in user fees for the first two years of the contract. All fee increases must be approved by the county. COMARCO splits the airports' net income with the county according to a pre-arranged formula; the county puts all these revenues in its Aviation Division budget and uses them for capital improvements at the airports.

COMARCO was required to offer jobs to all 56 county airport workers. Of these workers, two assistant managers and eight service workers went to COMARCO, five stayed with the Aviation Division, one resigned, one retired, and the others were transferred to other positions within the county's public works department. None were laid off.

C. Air Carrier Airport/Sale

The largest airport privatization to date was the British government's public share offering of the former British Airports Authority in 1987. At the time, BAA was the owner/operator of the three main London airports and the four principal Scottish airports (one of which, Prestwick, it subsequently sold). The initial share offering valued the company at \$2.5 billion. Three years later, in 1990, the market value had grown to \$4 billion, and by early 1994 to over \$8 billion.

What difference has privatization made to BAA's operations? A Reason Foundation study in 1990 addressed five indicators: capital investment, productivity and efficiency, pricing and revenues, noise mitigation, and customer satisfaction, and found positive results in all five.³

² Darren Leon, "Firm's Job with County Airports Grounds Critics," *Antelope Valley Press*, May 2, 1993.

³ Robert W. Poole, Jr., "Airport Privatization: What the Record Shows," Policy Study No. 124, Los Angeles: Reason Foundation, August 1990.

As a public authority, BAA had limited access to capital; essentially, it was permitted to borrow only from the British Treasury, and the Treasury set stringent annual limits on borrowing by state-owned companies. In the first three years following privatization, BAA capital spending more than doubled. Terminal expansion at all three London airports accounted for the majority of the initial investment; in addition, on-airport hotels were added at all three. Furthermore, plans were drawn up for construction of Heathrow Express, a high-speed rail line connecting Heathrow with central London (in a joint venture with British Rail). Thus, a capital-short enterprise was able to increase capital spending on productive projects as a result of being privatized.

Economic theory predicts that a privatized enterprise would have strong incentives to operate more efficiently. Data from BAA showed a steady upward trend from 1983 (as BAA began gearing up for privatization) to 1990 (the year of the study) in labor productivity, as measured by operating revenue generated per employee and by passengers handled per employee. In addition, BAA's unit labor costs (in terms of £ of expense per passenger) trended steadily downward.

Airlines typically express concern that landing fees must increase as a consequence of airport privatization. Airports that possess monopoly power (such as BAA's London airports) might be able to increase landing fees above market levels. Because of this, the act authorizing BAA's privatization provided for regulation of airside charges. Rather than controlling individual charges, however, the price-cap regulation (RPI minus X, where RPI is the retail price index) applies to each year's airside revenue per unit of aircraft operation. In other words, the formula requires that the average unit charge on the airside increase by less than the rate of inflation. (The value of X is set by the regulator for each five-year period.) Thus, in real, inflation-adjusted terms, airside charges have steadily *decreased* at BAA's London airports.

This flexible form of regulation permits the pricing *structure* to be based on market principles. Thus, at Heathrow and Gatwick, where significant airside congestion exists at certain hours and certain seasons, peak landing charges are much higher than those off-peak. In addition, BAA has abandoned the traditional weight-based approach to landing fees, recognizing that the cost of handling the landing or takeoff of an aircraft bears little relation to its weight. Further, BAA makes use of noise-related surcharges and rebates to promote a shift toward quieter aircraft.

With its airside revenues somewhat constrained by price-cap regulation, BAA has had strong incentives to increase revenues on the landside. Data show that while airside revenues made up 54 percent of BAA operating revenues in 1983, that fraction had declined to only 42 percent by 1990 (while overall revenues more than doubled). BAA accomplished this by aggressive expansion of the type and quantity of retail concessions in its terminals. Focusing on brand-name retailers and instituting a well-publicized guarantee that prices at airport shops would be no higher than in the same shops elsewhere, BAA developed the Heathrow and Gatwick terminals into the equivalent of shopping malls.

BAA's airports remained subject to the same noise regulations before and after privatization, and the data showed continued downward movement in the figures for the amount of land impacted by various levels of airport noise.

Finally, data from BAA's regular surveys of customer satisfaction (on such matters as catering, baggage-cart availability, cleanliness, and staff) showed either no change or slight improvements in the first three years following privatization.

D. Air Carrier Airport/Build-Operate-Transfer

In the mid-1980s Transport Canada, the federal agency that until recently owned and operated virtually all of Canada's major airports, decided that a new international terminal was needed at Toronto's Pearson International Airport. Its initial conceptual design called for a facility of 15 to 17 gates. Following the agency's normal development procedures, Transport Canada estimated that this facility would take seven years to develop, at a cost of C\$1 billion.

Instead of pursuing the traditional approach, the agency opted for a BOT project. The resulting terminal, which opened in 1991, has 24 gates (plus five in a satellite terminal for Canadian Airlines). From drawing board to opening day, it took just 33 months, rather than the seven years projected by Transport Canada, and cost only C\$700 million rather than C\$1 billion. In addition, it operates with 25-percent fewer people than in Transport Canada's plans.

Terminal 3 was developed and is operated by a Canadian/U.S. joint venture, of which Lockheed Air Terminal is the U.S. member. Their 40-year concession (franchise) includes a land lease on 130 acres (with a 20-year option). The project included the 1.2 million sq. ft. terminal building, a 3,300-car parking garage, a 500-room hotel, and five miles of access roads with six overpasses. The terminal was designed with extensive retail space, including a mini shopping mall.

Terminal 3 incorporates several innovations, including the first airport shopping mall in North America and the first cash-and-carry duty-free operation in Canada. Unlike typical U.S. practice, the airport terminal company retains control of all gates (i.e., they are not leased to individual airlines) and controls the arrival and dispatch of all aircraft onto the terminal's apron areas. It also controls the flight-information (closed-circuit TV) system, the public address system, and the baggage systems, rather than delegating some or all of these to individual airlines.

V. LEGAL ISSUES

A. Federal Grant Eligibility

Under the Airport & Airway Improvement Act of 1982 and subsequent amendments, the Federal Aviation Administration (FAA) makes grants to air-carrier and general-aviation airports. Air-carrier airports receive *entitlement* grants based on a formula related to annual enplanements. They and other airports may also apply for *discretionary* grants for specific projects, in competition with other airports.

Airports accepting federal airport grants (generally known as AIP grants, meaning Airport Improvement Program grants) must sign contractual grant agreements with the FAA. Under the terms of those agreements, the recipient (the airport "sponsor") must provide assurances that the airport be open to all users on a nondiscriminatory basis, that airport charges be fair and reasonable, and that "all revenues generated by the airport" must be used only for airport (or airport-system) purposes. It is well-established in federal law that the FAA's control over such economic issues as airport access and charges stems from the grant agreements. If an airport did not make use of federal grants, the FAA's jurisdiction would be limited to safety and air traffic control issues only.

How does privatization affect grant eligibility? Under contract management, the government which owns the airport remains the sponsor, and the airport remains eligible for the same types of grants for which it was eligible when managed directly by the municipality. Likewise, under most forms of long-term leases and BOT arrangements, the government which remains the airport owner would remain the airport sponsor, so grant eligibility would be unchanged.⁴

With respect to an airport sale, post-1982 federal law permits discretionary and noise-related grants to be made to privately owned airports, but entitlement grants are not permitted. Thus, an airport can be owned by the private sector and operated by it for profit and still receive federal grants for capital projects (though it must compete for such grants against other airports).

⁴ Although the FAA raised questions about the 1990 proposal by Albany County, New York for a long-term lease of its airport to a private consortium, it did not maintain that such a lease was per se in violation of the grant agreements. Indeed, grants continue to flow to airports leased to the private sector, such as Atlantic City and Morristown.

To sum up, general-aviation airports can make use of any form of privatization without any impact on their grant status, since they do not receive entitlement grants (which are based on passenger enplanements) to begin with. Air-carrier airports can receive discretionary and noise related grants under any form of privatization, but if privately owned, cannot receive entitlement grants. Entitlement grants are a relatively small component of the revenue of large and medium airports, but can be significant for smaller air-carrier airports.

B. Lease or Sale Proceeds

In Section III it was claimed that a municipality could legally obtain a return on its investment in its airport, despite the federal prohibition on “diverting” airport revenue, by either leasing the airport (and receiving lease payments, not profits) or one-time sale proceeds. How strong are the legal arguments for this position?

This question has been examined by several legal experts, each of whom has concluded that it is legally sound. These include former U.S. Transportation Secretary Jim Burnley⁵ and former FAA Chief Counsel E. Tazewell Ellett.⁶ One of the most detailed assessments was carried out by the law firm of Skadden, Arps, Slate, Meagher & Flom for the City of Los Angeles in 1992.⁷ The Skadden, Arps assessment concludes that current federal law permits the sale or lease of a municipal airport to a private firm, and that a privatized airport would be eligible to receive federal grants, as outlined in the previous subsection.

What about the proceeds from such a transaction? With respect to a sale, Skadden, Arps concluded that a municipality would be able to use sale proceeds for general purposes because the term “airport revenues” as used in the 1982 Act (and amendments) refers to *operating* revenues, not the one-time proceeds from an asset transaction. This would be consistent with: 1) the legislative history of the 1982 Act; 2) accounting definitions; and 3) the FAA's own AIP handbook, which states that “Airport revenue does not include proceeds from the sale of real property owned by the sponsor.”⁸

With respect to lease payments, Skadden, Arps notes that the FAA Compliance Manual already provides for the lease of entire airports. Not noted by Skadden, Arps is the fact that lease payments being made by private lessees in the case of airports such as Atlantic City are going “off the airport” today, to the general funds of the underlying government owners. The memorandum also notes a 1991 Department of Justice opinion regarding the proposed lease of Albany Airport, in which DOJ assumed that the lease payments were “airport revenues” but could still be used for general-fund purposes to the extent that they represented a recovery of the local government's original investment in the airport. But it notes that a 1992 Executive Order may supersede this opinion.

President Bush's Executive Order No. 12803 (April 1992) was intended to remove federal barriers to the lease or sale of federally aided infrastructure facilities, including airports, by state and local governments. It directs the federal agencies which have made such grants (e.g., the FAA) to approve such requests. The only conditions attached to such transactions are that: 1) the proceeds from the sale or lease be used in accordance with the provisions spelled out in the Order (and with pre-existing federal law); and 2) that some sort of

⁵ Jim Burnley, Jim Pitts, and Karen Grubber, “Legal Analysis and Policy Review Pertaining to Public/Private Partnership for Commercial Airports,” Washington, D.C.: Winston & Strawn, March 24, 1993.

⁶ E. Tazewell Ellett, “FAA's Airport Privatization Policy: Past, Present, and Future,” *Public Works Financing*, October 1992.

⁷ Karen J. Hedlund and John P. Giraud, “A Legal Memorandum to John F. Brown Company Inc. Regarding Federal Restrictions on Transfer of Airport Revenues and Sale or Lease of Airport Property,” Los Angeles: Skadden, Arps, Slate, Meagher & Flom, June 12, 1992.

⁸ “FAA Airport Improvement Program Handbook,” Order 5100.38A, Washington, D.C.: Federal Aviation Administration, 1989, p. 73.

mechanism (either market, contract, or regulatory) be in place to ensure that the facility continues to be used for its original purpose and that user charges will be structured so as to protect users from abuse.

E.O. 12803 calls for the sale or lease proceeds to be used as follows. The first claim on the proceeds is for the government owner to recover its original investment in the facility, including any transaction costs. These funds may be put into its general fund. If there are funds remaining, the second claimant is the federal government, which may be entitled to recoup a portion of the previous federal grants to the facility (the full amount less accumulated depreciation, based on IRS accelerated depreciation tables). If there are still funds remaining, the final portion must be used only for investment in other infrastructure or for reducing debt or taxes.

In 1994 President Clinton issued Executive Order 12893 on Principles for Federal Infrastructure Investment. It specifically directs each agency with responsibility for transportation, water, energy, and environmental facilities to “seek private-sector participation in infrastructure investment and management” and seek to work with state and local governments to “minimize legal and regulatory barriers to private-sector participation.” It also endorses market pricing for infrastructure and sound cost-benefit analysis. E.O. 12893 supplements and reinforces E.O. 12803; it does not supercede it.

C. Existing Bonds/Tax-Exemption

A change in the ownership (sale) or de-facto ownership (long-term lease) may affect the status of existing bonds used to construct a portion of the airport. In most cases, these bonds will have been issued by the municipality on a tax-exempt basis. Most airport bonds are revenue bonds (secured solely by airport revenues), though some may be general-obligation bonds (secured by the general taxing powers of the issuing government). Three factors must be looked at in connection with these bonds.

First, the bonds themselves must be reviewed to determine if there are any provisions that restrict the use of revenues or require the bonds to be defeased or redeemed in the event of a sale or lease. Even in the absence of such provisions, the bond language may require that the bonds satisfy IRS requirements as to tax-exemption. Second, state law must likewise be reviewed to see if there are any comparable provisions. Having to defease or redeem the bonds may not prevent a sale or lease from taking place, but may affect its cost and therefore its financial feasibility.

The third factor to consider is the IRS itself. Thanks to a recent change in its procedures, the IRS is now able to consider requests to retain the tax-exempt status of bonds when the facility which they have financed is sold or leased. In 1993 the agency issued Revenue Procedure 93-17, which allows interest on outstanding bonds to continue to be tax-exempt when the facility is sold or leased, if certain other conditions are met. The most important of these is that the disposition proceeds (i.e., the lease or sale payments) must be used in an alternative manner that would have qualified for tax-exempt status. Devoting the proceeds to other public works investment, for example, would be one such purpose. In addition, the facility must continue to be used for its original purpose for at least five years, and the new owner or lessee must transact business with the original government owner on an arms-length basis and for fair-market value.⁹

Hence, provided that neither state law nor the bond covenants prevent it, existing tax-exempt airport bonds may remain in existence (and tax-exempt) following the sale or long-term lease of an airport.

D. Access to Future Tax-Exempt Bonds

The difference in interest rates between taxable and tax-exempt bonds is in the vicinity of 200 basis points (e.g. two percentage points). In financing airport expansions, that difference in interest costs can lead to

⁹ Karen Hedlund, “New IRS ‘Change-in-Use’ Rule Protects Bonds Issued to Finance Privatized Governmental Assets,” Los Angeles: Skadden, Arps, Slate, Meagher & Flom, March 29, 1993.

major differences in debt-service expenses. Thus, airport users would benefit from the availability of less-expensive debt, other things being equal.

Under contract management, capital expansions are the responsibility of the government owner of the airport, making use of tax-exempt bonds. Under BOT and long-term lease arrangements, it is generally possible for the government owner to issue tax-exempt revenue bonds on behalf of the private lessee or franchise-holder, with project revenues earmarked for debt service. (This is simply a variant on the common method of financing airline maintenance facilities and terminal buildings, in which the municipality or airport authority issues revenue bonds on behalf of the airline(s) committing to use the facility for a long-term period.)

Under current federal and state tax law, it appears difficult or impossible for tax-exempt bonds to be issued for an airport which is owned and operated by the private sector. As a matter of public policy, this lack of a “level playing field” between public and private ownership is likely to skew the choice between public and private ownership, though it might not prevent full private ownership in certain cases of high profit potential.

VI. POLICY ISSUES

A. Loss of Public Control

Airports are valuable community resources, providing a needed public service. Thus, it is to be expected that privatization, especially via sale or long-term lease, raises concerns about potential loss of public control. There are a number of mechanisms that can protect the public interest, while still retaining the benefits of private-sector operation.

Under a management contract, the contract itself spells out the requirements and constraints under which the firm must operate. Although the more constrained the conditions, the less scope there may be for innovation and efficiency gains, the contract can potentially include any provisions desired. One particular benefit of contracting out is that measurable performance requirements can be specified, with appropriate penalties for failure to meet them (e.g., financial penalties and even termination of the contract). This is often a greater degree of real accountability for results than exists when the airport is operated by a government department that will remain in place regardless.

A lease or franchise agreement, though much longer-term in nature, offers similar potential for including explicit provisions to protect the public interest and require achievement of certain performance targets. The temptation to micromanage the firms's operations via lease provisions should be resisted, however. Because far more of a financial commitment (and hence risk) by the private sector is involved in a lease than in a management contract, economic incentives will accomplish far more than detailed prescriptions in such arrangements.

If an existing airport is sold, or if a new airport is built from the start as a private venture, how can the public interest be protected? With a sale, government can condition the sale on several factors. A *deed restriction* can be included, guaranteeing that the property continue to be used for airport purposes for, say, 99 years. Government may wish, as in Britain and some other countries, to retain a single share of ownership (the British call this a *golden share*), with special voting rights designed to protect specific public-interest concerns (e.g., foreign ownership in the case of BAA airports).

For either a new airport or an airport sale, government could grant a *perpetual franchise*, administered by a municipal entity such as an airport commission. Under such an arrangement, the private firm would hold title to the airport in perpetuity, subject to compliance with the terms of the franchise. The commission would be able to revoke the franchise if the firm violated its explicit terms.¹⁰

¹⁰ William H. Payson and Steven A. Steckler, “Expanding Airport Capacity: Getting Privatization Off the Ground,” Policy

B. Economic Regulation

Airports are often referred to as a municipal utility, like electricity, gas, telephones, or water. Although an airport is very capital-intensive, like those utilities, the key question is whether or not it possesses monopoly power. If it does, then the issue becomes the most appropriate way of dealing with that power.

The first question is to what extent monopoly power exists, and for what set of customers. In most cases, the airport's land-side services (restaurants, car-rentals, etc.) are subject to competition from off-airport suppliers; no airport user is forced to deal with them. So these services generally will not be candidates for regulation.

On the airside, many cities have at least one general-aviation airport in addition to their air-carrier airport. Thus, GA users do not face a monopoly situation. Airline passengers may have the option of driving 50 or 75 miles to another location with airline service, in which case they are not really victims of a monopoly even with only one air-carrier airport in the city. And many urban areas (e.g., New York, Chicago, Detroit, Dallas, Houston, Los Angeles, San Francisco) have multiple air-carrier airports, such that privatizing one of them would not create a monopoly situation. Only selling an urban area's entire set of airports to a single firm (as the British did by privatizing BAA, rather than selling Heathrow, Gatwick, and Stansted separately) would lead to monopoly conditions.

But suppose that some degree of airside monopoly does exist under privatization. What are the possible remedies? First, if the airport continues to receive federal grants, its pricing must meet the FAA's definition of fair and reasonable, in compliance with the grant agreements. Second, unlike the public sector, privately owned airports would be subject to federal and state antitrust laws, which prohibit both price discrimination and price gouging. Third, international air service is subject to bilateral treaties which protect airlines (and hence passengers) from discriminatory pricing.

Given the protections offered by these three mechanisms, it is not clear that any further regulation would be necessary. But if it were, several choices are available. One would be to subject the airport to traditional public utility regulation, administered by the state public utilities commission (PUC). Given that in all likelihood only a portion of airside services would exhibit monopoly aspects, the costly and time-consuming PUC regulatory process would not be appropriate.

Two more-flexible alternatives are British-type price-cap regulation and franchise-based rate-of-return ceilings. Under the former, BAA's airside charges are limited each year to increase by less than the rate of inflation, as noted in Section IV, via the RPI minus X formula. All the recently privatized British utilities are regulated in this way. The alternative, as used in California's BOT franchises for private toll roads, is for the franchise agreement to set a ceiling on the annual rate of return the company can realize. This permits its pricing to respond to market conditions, but requires that any profits earned above the ceiling amount go into the state transportation fund.

As a general rule, any form of explicit economic regulation imposes costs and will reduce the attractiveness of an airport to potential investors. Thus, careful tradeoffs must be made to determine the extent of likely monopoly problems and the least-restrictive way of dealing with them.

C. Safety

Some have raised the question of whether privatized airports would be as safe as publicly owned airports. It is important to remember that, regardless of the form of privatization, the FAA would remain as the airport's safety regulator and operator of its control tower and landing aids.

In addition, as Payson and Steckler have pointed out, the incentives facing a private airport owner or lessee would promote *greater* concern for safety, for several reasons.¹¹ First, compared to a municipal entity, an airport firm would have less protection against full legal liability, which would provide strong incentives to go the extra mile on safety (e.g., possibly spending its own funds to add a ground collision-avoidance radar rather than waiting years for the FAA to procure one). Second, any public perception of safety laxness would tend to drive business away to alternate airports. Third, the franchise or lease agreement could include specific provisions regarding safety, over and above meeting the FAA's minimum requirements, which, if breached, would be grounds for penalties or termination.

D. Noise

As in the case of safety, the existing legal rules and regulations concerning airport noise would apply equally to a private buyer or lessee. Beyond this, the firm would have strong incentives to be responsive to community concerns over airport noise. A private firm may be perceived by potential noise litigants as having deeper pockets than a municipal government. This will give the company strong incentives to minimize the risk of noise litigation via strong noise-control efforts. In addition, a private firm might emulate BAA in imposing a surcharge on landing fees for noisier aircraft. The record to date of privately owned airports in Britain and privately managed airports such as Burbank is one of steady reductions in community noise exposure.¹²

E. Liability

Some have questioned whether a private firm could afford to insure against the large liability exposure of owning and operating a major airport. The magnitude of this exposure is comparable to that against which major airlines must insure (e.g., the collision of two fully loaded 747s). An extensive international reinsurance industry has developed to deal with large risks of this type. The basic idea is that the primary insurance carrier for a particular risk reinsures by breaking up the exposure into smaller pieces (typically 5 percent) which are borne by other insurers. Thus, in the event of a major accident, no single insurer bears more than a small portion of the cost. BAA has had no problem insuring against the liabilities of operating two of the world's largest and busiest airports, Heathrow and Gatwick.

F. Bankruptcy

What would happen if an airport firm encountered financial difficulties and had to file for bankruptcy? The same question arises in connection with investor-owned water or electric utilities. First, it is important to remember that a chapter 11 filing represents a reorganization of the firm, not its dissolution. Under Chapter 11, the firm continues to operate, providing the same basic services. In the more severe situation of a dissolution (Chapter 7), the physical facilities do not disappear; they remain in place, available for operation by new owners and managers.

The problem for government is to make sure that the airport's vital services continue during bankruptcy proceedings. The lease or franchise agreement should include default provisions entitling the municipality to hire an interim operator, should the original firm be unable to live up to its commitments to provide airport services due to bankruptcy.

G. Safeguarding Lease or Sale Proceeds

¹¹ Payson & Steckler, *ibid.*

¹² Robert W. Poole, Jr., *op. cit.*

A final public-interest issue is to ensure that the proceeds from converting a city's physical assets (the airport) into financial assets (the sale or lease payments) are not wasted. One way to do this would be to enact a charter amendment specifying the use to which proceeds from such asset transactions could be put.

For example, proceeds from asset sales could be treated like an endowment, dedicated to a specific purpose (e.g., public safety or debt reduction). The principal would be invested and only the earnings would be available each year, for spending on the designated purposes.

For leased assets, the ongoing stream of lease payments could be dedicated, by charter, to certain designated purposes (such as other infrastructure investment).

The purpose of these mechanisms is to make sure that the proceeds are used wisely, rather than being frittered away. In this way, the sale or lease of municipal assets is not “selling the family silver,” as critics may charge. It is simply changing the form of the asset, from physical to financial.

VII. IMPACTS ON STAKEHOLDERS

A. Airlines

U.S. airlines are generally considered to be opposed to airport privatization. Indeed, airlines were the principal opponents of the proposed sale of Albany Airport in 1989 and have spoken out against proposed privatizations of Baltimore-Washington International and Los Angeles International.

But there are signs that airline opposition may be waning. In the Albany case, the final version of the long-term lease proposal succeeded in winning the airlines' endorsement (even though it ended up not going through, for other reasons). The parties in question had worked out lease terms which adequately protected the airlines' exposure to future charges, while providing for development of a badly needed new airport terminal.

More recently, airlines have been outspoken in opposing grandiose expansion plans at municipal airports such as the (now-canceled) \$3.2-billion JFK 2000 project at New York's Kennedy International and the new terminal at Washington National. Airlines have also been quite concerned over the new Denver International's cost overruns and delayed opening. The private sector cannot afford to build “Taj Mahal” terminals or to add runways before they are truly justified in terms of return on investment. Thus, airlines would be better protected from costly, premature projects if the private sector were more heavily involved in the investment decisions.

As airlines observe successful projects such as Toronto's Terminal 3, as well as encountering privatized airports in Europe, Australia, and Latin America over the next few years, they should become more accommodating to privatization proposals, so long as their interests are explicitly taken into account.

It is also interesting to note that at least one airline's parent company, AMR (parent of American), is attempting to enter the airport privatization business itself.

B. Passengers/Customers

The trade-off for airport passengers and general-aviation pilots is better service versus potentially higher prices. As the case studies in Section IV illustrate, the relatively small number of real-world instances of airport privatization do not support fears that privatization equates to higher prices for less service.

For passengers, the expanded retail operations brought about by BAA in Pittsburgh and London, and by Lockheed and its partners in Toronto, have been very popular. In these cases, the private operators' interest

has been to expand total sales volume via fair pricing of a greatly expanded variety of retail offerings (in contrast to the typical public-airport approach of charging high prices for a very limited selection, taking advantage of the temporarily captive audience).

General aviation users at the Los Angeles County airports and at privately operated Morristown, Republic, and Teterboro have been mostly positive about improvements in pavement and services at those airports under private management. Here again, the improvements have been brought about not by jacking up the prices but by making the same dollars go farther thanks to improved operating efficiencies.

C. Taxpayers

Airport privatization can bring benefits to taxpayers in several ways. For smaller airports that currently must be subsidized from general-fund revenues, contract management offers the prospect of reducing or eliminating that subsidy, thereby reducing the drain on taxpayers (many of whom may not even use the airport). For medium-size airports which already break even, contract management may result in higher retained earnings and therefore less need to borrow (thanks to operating efficiencies), which means lower debt service costs and potentially lower user charges.

Airports large enough to be attractive candidates for lease or sale can produce larger benefits for taxpayers. Either the leasehold interest or the entire airport may be shifted to the property tax rolls, spreading the property tax burden more evenly through the community (and making future increases in rates less likely). In addition, as already noted, the lease payments or sale proceeds can be used for other needed public purposes, substituting for tax funds that would otherwise be required for those purposes.

D. Airport Staff

Employees traditionally fear the loss of jobs whenever a government function is privatized. Or they worry about less-pleasant working conditions or lower levels of benefits.

In contrast to some municipal departments, airports are generally run in a more businesslike manner; they are seldom hugely overstaffed, and one seldom finds grossly inefficient work practices. Especially when traffic levels are growing, privatization may take place without any layoffs (as was the case when BAA was privatized and when Lockheed took over the management of Albany Airport).

Governments sometimes require bidders to make job offers to all existing workers of an enterprise to be privatized. Bidders are often willing to agree to such a condition, as long as they will subsequently have all the normal rights of management: to hire and fire based on performance, to determine compensation and benefit levels, to define work rules and conditions, etc.

To ease the transition, the government may want to establish provisions to encourage those near retirement age to take early retirement, and to offer transfers to vacancies in other departments for those airport employees not wanting to shift to the private sector. Vested pension benefits must also be safeguarded. Many jurisdictions have managed such transitions smoothly, and compiled experience is now available to help.¹³

VIII. IMPLEMENTATION

Once a municipality (or airport authority or state transportation agency) has determined that privatization might be applicable to an airport which it owns, what steps must be taken to move forward? Most or all of the following steps will apply in most cases.

¹³ John O'Leary and William D. Eggers, "Privatization for Public Employees: Guidelines for Fair Treatment," How-to Guide No. 9, Los Angeles: Reason Foundation, August 1993.

A. Request for Information/Strategies

In order to ascertain the private sector's degree of interest, the agency can publish and publicize a request for private firms to submit expressions of interest in private management, operations, and/or development of the airport. If the agency is not sure which mode of privatization would be most suitable, this process can obtain expert opinions from airport professionals at very little cost to the agency. In 1994 Indianapolis received eight responses to such a request, from domestic as well as overseas firms. The Dupage, Illinois airport authority received 11 responses to its request for privatization ideas for its general-aviation airport.

B. Consultant Assistance

If the agency has already decided upon a privatization mode (contract management, lease, sale, BOT, etc.), its first step should be to retain a consultant knowledgeable about both airports and privatization to review its financial and operational data and assist with designing the competitive process and the required documents (RFQ, RFP, etc.). If the first step has been a request for strategies, the consultant can be of great help in assessing the (most likely) varied responses and helping the agency decide which mode of privatization makes the most sense, given the agency's objectives. Legal advice may also be advisable at this step, especially in the case of large airports and/or long-term modes of privatization (lease, sale, BOT).

C. Request for Qualifications

In the case of large, long-term privatization competitions, many governments make use of a two-step procurement process. The first step is to weed out those firms or consortia that are judged to be unlikely to succeed in meeting the requirements for operating, managing, and/or developing the facility. Hence, in this step the firms are asked to document in some detail their experience and qualifications. It is generally wise to spell out in some detail in the Request for Qualifications (RFQ) what factors will be used to evaluate the responses. This leads to some degree of self-selection, as clearly unqualified firms will be able to conclude that they have little hope of being judged qualified. Another way to discourage clearly unqualified firms is to require a filing fee large enough that only serious contenders will pay. Making the requirements and selection criteria as clear as possible may also serve to minimize the likelihood of legal challenges by firms which do not make the grade.

D. Request for Proposals

The next step is to issue a formal request for proposals to those firms which constitute the "short list," by virtue of having survived the RFQ process. For large procurements, the agency may be well-advised to hold a bidders' conference for these firms prior to finalizing the RFP, at which it presents an early draft of the document and seeks feedback and suggestions from them. This kind of interaction can lead to a more realistic RFP, which will lead to more responsive proposals and should make the subsequent negotiations with the winning firm go more smoothly.

Given that airport privatization is at an early stage in the United States (there is still no clear-cut policy guidance on the subject from the FAA or its parent, the U.S. Department of Transportation), an important element in the RFP should be for the bidder to document its plan for obtaining DOT approval of the transaction (which will be required in most cases, if the airport is to continue to receive federal AIP grants). This will involve demonstrating to the various stakeholders, especially the airlines serving the airport, that the privatization will not harm their interests.

E. Proposal Evaluation

Depending on the size and complexity of the privatization, bidders should be given from two to six months to prepare and submit their proposals. Rigorous evaluation should then be carried out by senior officials, possibly with consultant assistance. Here again, it is important that the evaluation process be as objective and

“transparent” as possible, with detailed evaluation criteria having been spelled out in advance in the RFP. In addition, the scoring of proposals against these criteria should be documented and be made public following the completion of the process. The objective is to guard against subjective or biased decisions, as well as to minimize the likelihood of legal challenges by losing bidders.

F. Negotiation

The next step will be the negotiation of a legal agreement between the airport owner and the winning bidder. Depending on the privatization mode, this will be either a management contract, a lease agreement, a BOT franchise, or a bill of sale. Consultant and (especially) legal advice will be essential at this step. Once the agreement has been negotiated, any needed stakeholder agreements will also have to be obtained (e.g., airline lessees or signatories, U.S. DOT).

IX. CONCLUSION

Airport privatization is relatively new to the United States, but is rapidly becoming the model for airport operations around the world. Depending on the economic and political circumstances, contract management, a long-term franchise for new facilities, a long-term lease, or outright sale can offer benefits to taxpayers and airport users alike. The appropriate mode of privatization depends on the specifics of each case, and must be the subject of careful analysis. Done well, privatization can provide net benefits for all parties by adding value to the airport's operations. Airlines can receive assurances of cost controls; air travelers can obtain a higher level of service; the airport agency can obtain some new revenues; and the new airport operator a new source of business.

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