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Airport Finance: A Brief Overview

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Summary

Airports in the U.S. national system are nearly always public sector enterprises that operate under a city, county, regional or other charter such as a port authority. Although these airports are public enterprises, they are typically managed as businesses. Most airport operating revenues come from airfield revenues (such as landing fees), concession agreements, or rent from leased areas at the airport. For capital development needs airports rely on bonds, federal Airport Improvement Program (AIP) grants, passenger facility charge (PFC) revenues, state and local grants, and surplus airport revenue. Federal involvement in airport finance is mostly concerned with airport capital improvements intended to support policies concerning capacity, competition, noise, safety, and the availability of air service nationwide. This report will not be updated.

Airport Finance

Airports in the U.S. national system are nearly always public sector enterprises that operate under a city, county, regional or other charter such as a port authority. Although these airports are public enterprises, they are typically managed as business enterprises. Airport operating revenues support costs that include day-to-day operations, bond repayment, and other operating expenses. Capital development funding, for the most part, comes from a combination of private and public sector sources including, tax-exempt bonds, the Airport Improvement Program (AIP), passenger facility charges (PFCs), state and local grants, and unexpended airport revenue.

Operating Revenues

These are airport revenues provided by fees, rents, and other charges that are directly associated with the running and operation of the airport.¹ Operating revenues include:

¹ In this report all references to airports or the national airport system refer to those airports listed in the National Plan of Integrated Airport Systems (NPIAS). See, U.S. Federal Aviation Administration (FAA). *National Plan of Integrated Airport Systems (NPIAS) 1993-1997*. April (continued...)

airfield area revenues, terminal area concessions, airline leased areas, and other leased areas.²

- 1) Airfield area revenues/landing fees. These fees include the use of the landing strips, clear zones, and safety zones; temporary parking and service areas; and emergency services. These fees can be assessed by gross landing weight, gross takeoff weight or by a percentage of an airline's gross revenue at the airport. Small airports may charge a fixed flat weight or gross landing weight fee but often simply charge a fuel "flowage" fee that is levied on each gallon of aviation fuel sold at the airport.
- 2) Terminal area concessions. Businesses contract with airports to set up a wide variety of enterprises that can range from operating parking garages or hotels to running snack or gift shops. These concessions are often established by competitive bid.
- 3) Airline leased areas. Airports also collect rent from airlines for terminal space, hangars, cargo terminals and land. The terms for these leases are set forth in the airline agreements.
- 4) Other leased areas. Airports may also rent land or facilities to non-airline tenants. Examples of other leased areas include industrial parks, cargo terminals, and agricultural land.

Some airports have sources of revenue that would continue even if the airport itself shut down. These nonoperating revenues include investment income, rent from leasing non-airport property or equipment, and income from consultancy services.

The Revenue Mix. The mix of operating revenues varies greatly from airport to airport. It is influenced by the conditions written into an airport's airline agreements, the amount of traffic sustained, and the strength of revenue flows from business concessions and leases. Large and medium hub airports are more likely to have a more complex system of charges and fees than small airports. Smaller airports generally have less diversified revenue streams and are less likely to have substantial revenue from concessions and leases.

Operating revenues are derived from the operation of the airport and are used mainly to pay day-to-day costs. Most capital improvement funding is supported from sources other than operating revenues (airport revenue ranks fifth among the five major sources of capital improvement funding). Operating revenues and airline agreements are important elements of a discussion of sources of airport capital projects because of the impact they have on an airport's ability to attract and pay for private capital.

¹ (...continued)

1995. Washington, 1995. [150] p. According to the FAA, currently all but 180 of the 3,580 NPIAS airports are publicly owned.

² For further reading on airport finance see, Kluckhohn, Harry. *Financing U.S. Airports*. In Ashford, Norman and Moore, Clifton A. *Airport Finance*. New York, Van Nostrand Reinhold, 1992. p. 26-55. Also see, U.S. Congress. Congressional Budget Office. *Financing U.S. Airports in the 1980s*. Washington, CBO., 1984. p. 15-39.

Airline Agreements

Although U.S. airports are typically publically owned, they operate in a business environment that is shaped in part by their operating relationship with the commercial airlines. This operating relationship has an impact both on the way airport capital spending is financed and also on the different views that airports and airlines take on policy issues.

Airports generally negotiate “airport use agreements” with their tenant airlines. Use agreements are legally binding agreements that define how the risks and responsibilities of airport operation are shared. There are two types of airline agreements: residual cost agreements and compensatory cost agreements. Each of these mechanisms has implications for both rate setting and airport improvement financing.

1) **Residual Cost Agreements.** This approach sets rates and charges based on the net revenue an airport needs to cover expenses including debt service. If the airport cannot meet its costs, the rates airlines pay are raised to meet the shortfall. If the airport runs a surplus the rates are adjusted down. Under residual cost agreements airports know their budgets will be balanced and airlines are granted more control relative to the airports over airport capital improvement spending decisions.

2) **Compensatory Cost Agreements.** This approach sets rates and charges based on recovery of costs for the facilities used. The airports could assume more risk in this arrangement because an airport must make up any shortfall from other sources of airport revenue. The cost of “public space” is borne by the airport and is usually paid for with revenue from non-airline sources. Under this approach the airport can run a surplus and use it for purposes other than reducing the airlines’ rates. In comparison with most residual cost agreements, airports accept more financial risk but also retain more control relative to the airlines on airport capital improvement spending decisions.

Other Features of Airline Agreements.

1) **Majority-in-Interest Clauses (MII).** An MII clause gives the airlines that account for the majority of the traffic at an airport the right to review and accept or veto any capital projects that could lead to significant increases in the rates that they pay for the use of airport facilities. MII clauses are typically only found in residual cost agreements. Airports that operate under MII agreements may have less freedom to undertake capital improvement projects.

2) **Term-of-Use Agreements.** Airports and airlines also negotiate the length of use of the airport’s facilities. Residual cost agreement airports usually have substantially longer term of use agreements than those that use compensatory cost agreements. This is because residual cost agreements are often designed to provide security for long-term airport bond issues. The length of use usually coincides with the term of the bond issue.

Capital Project Funding for Airports

There are five major sources of funds for airport capital project funding: bonds, Airport Improvement Program (AIP) grants, passenger facility charge (PFC) revenues, state and local grants, and surplus airport revenue.

It is important to keep in mind that the different sources are not always independent of other financing methods. For instance, PFCs, state and local grants, and surplus airport revenue can all be used to secure and repay bonds.

Table 1 shows airport capital funding sources using 1996 data.³ In 1996 bonds provided 58% of total funding or twice as much as the next two sources, AIP grants and PFCs. Bond proceeds are generally received as one-time lump-sum payments. Airport revenues and, increasingly, PFCs are used to repay bonds.

Table 1. Funding Sources for Airports' Capital Spending, 1996

Funding Source	1996 (in billions)	% of Total	Source of Funds
Tax-exempt bonds	\$4.104	58	Issued by state and local governments or airport authorities
Airport Improvement Program (AIP)	\$1.372	20	Appropriated by Congress from the Airport & Airway Trust Fund
Passenger facility charges (PFC)	\$1.114	16	Funds come from fees of \$1, \$2, \$3 per trip segment
State and local grants	\$0.285	4	Can come from state aviation fuel taxes, airport property taxes, fees, state bonds or appropriations.
Airport revenue	\$0.153	2	Generated from the airports' operations or derived from concessions and leases.
Total	\$7.028	100	

Bonds. The largest source of funds for airport development are debt issues. Because airport sponsors in the United States are nearly always local or state governments or a special public authority, the form of debt is usually a tax-exempt bond. The three most common types of bonds are:

1) General Obligation Bonds. These bonds are issued with the “full faith and credit” of the issuing government or special district entity(such as an airport authority). Full faith and credit means that the airport sponsor provides an unconditional pledge to pay the interest and principal over the life of the bond. General obligation bonds are typically issued for development projects at smaller airports.

³ G.AO, *Funding Sources for Airport Development*, p. 6-9. Table 1 is a slightly modified version of the table on page 6. For more detail also see GAO's graphs and charts on pages 32-49.

2) **Airport Revenue Bonds.** These bonds are secured by a pledge of an airport's revenues. The issuer pledges to make scheduled payments on the interest and principal over the life of the bond to the extent that the airport has sufficient revenue to make the payments. These bonds tend to be used by large and medium-sized airports whose revenues are large enough to provide adequate security.

3) **Special Facility Revenue Bonds.** These bonds are secured by a pledge of revenue from a particular airport facility. Special facility bonds are used to finance specific projects, such as a terminal building, often on behalf of a single airline tenant. The security is the stream of rental income the airport receives from the tenant.

Airport Improvement Program. AIP provides federal grants to airports for capital development projects. The grants are distributed according to formula or grant criteria in a manner to support national policies and priorities, including the safe operation of airports, minimizing noise impacts, increasing capacity, and improving service to state and local communities. Most AIP money is spent on "airside" projects such as runways, taxiways, aprons and noise abatement or safety equipment. The Federal Aviation Administration (FAA) requires a range of grant assurances from participating airports as a means of implementing federal airport policy.

Passenger Facility Charge. PFCs are charges an airport imposes on each passenger boarding at the airport to support capital development. The PFC is not a federal tax. It is a local tax levied at an airport with federal (FAA) approval. PFC funds are more likely to be spent on "landside" projects such as terminals or roads than are AIP grants.

State and Local Grants. States and local governments provide grants for airport improvements. Some state and local grants are used to fund federal matching grant requirements.⁴ State grants are more likely to go to smaller airports than are federal grants.

Surplus Airport Revenue. If an airport's revenues are large enough to more than cover its operating expenses and debt reserve requirements, these unexpended funds can be used for capital development and other uses. Federal law requires that all airport revenue be used for airport purposes. Large and medium hub airports have generated modest amounts of surplus revenue that are available for capital development but other commercial service airports often operate at or below the point required to maintain operating expenses.⁵

As can be seen in **Table 2**, smaller airports are typically more dependent on AIP funding for their capital needs. In 1996, for the 71 largest commercial airports, AIP

⁴ U.S. General Accounting Office (GAO). *Airport Finance: Funding Sources for Airport Development*. GAP/RCED-98-71, March 12, 1998. Washington, 1998. p. 17, 40-41.

⁵ GAO, *Funding Sources for Airport Development*, p. 41-42. In 1996, 5% of capital funds at large airports and 3% at medium airports came from surplus operating funds. Small hub, non-hub and other commercial service airports, as a whole, ran operating deficits in 1996.

represented 10.6% of development funding compared to 50.5% for the remaining 3,233 national system airports.⁶

Table 2. Distribution of Funding Sources By Airport Size

Funding Source	71 Large and Medium Airports	All Other National System Airports
AIP	10.6%	50.5%
PFC	18%	7.2%
State Grants	1.8%	11.9%
Special Facility Bonds	3%	16.2%
Airport Revenue	4.6%	0%
Airport Bonds	62.1%	14.2%

⁶ GAO, *Airport Financing: Funding Sources for Airport Development*. GAO/RCED-98-71, Mar. 12, 1998. Washington, 1998. P. 8.