City of Palo Alto

Office of the City Auditor

June 6, 2006

Honorable City Council
Palo Alto, California

cc: Joint Community Relations Commission

Review of Palo Alto Airport's Financial Condition and Comments on Santa Clara County's Proposed Business Plan for the Airport

SUMMARY

Santa Clara County's proposed business plan for the Palo Alto Airport (Airport) highlights Airport deficits and proposes to dramatically increase tie-down fees[1] to recoup the outstanding advance used by the County to construct, maintain, and support the airport. Our analysis of the financial statements, County documents, and City records indicates that Palo Alto Airport operations have generated more than $400,000 in adjusted net income[2] over the last 37 years that has been used to offset the County's original investment of $1,085,134 ($681,349 as of 6/30/05). In recent years, the Airport has remained profitable although County pooled and overhead costs total over 40% of the Airport's operating expenses. Because the Palo Alto Airport is bearing more than 30% of the County's pooled airport costs for its three airports, the operating income for the remaining two County airports would be adversely affected if the Palo Alto Airport lease were to be terminated. However, County staff indicates that significant budget reductions would offset the loss of Palo Alto revenue.

The proposed tie-down fees would be higher than nearby airports. We question whether current Airport users should bear the burden of historical deficits from the 1960's and 1970's (especially since recent years have been profitable), and specifically whether current Airport users should bear the full cost of 1973 Embarcadero Road improvements and 2005 Baylands levee repairs. Our analysis also indicates depreciation calculations should be cited with caution because depreciation expense does not affect the County's annual calculation of the outstanding advance. In addition, we suggest that the allocation of County overhead to the Airport be trued-up at the end of each year. Given the recent profitability of the Airport, we estimate the County's remaining outstanding advance of $681,349 may be settled before the lease expires in 2017, even without the proposed 30% increase in tie-down fees. Before 2017, the viability of the Airport may be impacted by: developments in the San Francisquito Creek project; implementation of some of the more feasible aspects of the County's proposed

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[1] Tie-down fees are charged to aircraft tenants for outdoor storage of their aircraft. The County operates 362 of the 468 tie-down spaces at the Palo Alto Airport. The other tie-downs and all of the hangars at the Palo Alto Airport are owned and operated by the FBOs.

[2] We are using the term "adjusted net income" to mean operating revenues (not including federal and state grants), less operating expenses (not including depreciation), plus net non-operating revenue/expense (including capital expenditures net of federal and state reimbursements).

master plan; and/or the advent of new very light jet aircraft. After 2017, opportunities exist to increase revenue after the County's subleases with the two fixed based operators (FBOs) expire.

RECOMMENDATION: Authorize the City Manager to notify the Santa Clara County Board of Supervisors that:

1) The City of Palo Alto supports moderate increases in tie-down fees at the Palo Alto Airport, but the fees should be competitive with fees at nearby airports.
2) Because it is a regional resource, the City expects and encourages the County to continue operating the Airport per the terms of the lease through at least 2017.
3) The County has benefited from operating the Palo Alto Airport, and should continue to maintain and improve Airport facilities per Federal Aviation Administration (FAA) regulations. The City has agreed to provide grant assurances when necessary.

BACKGROUND

Lease agreement: The City of Palo Alto (City) owns the land where the Airport is located. In April 1967, the County of Santa Clara (County) and the City entered into an agreement under which the County leased the Palo Alto Airport property from the City for a term of 50 years (through 2017) for a payment of $25 for the entire term of the lease. Under the terms of the lease, all revenue from the Airport was to be used to reimburse the County for expenditures made to construct and maintain the Palo Alto Airport, and for continuing operations, maintenance, and capital improvements on the airport premises. The County also agreed to pay the expense of relocating Embarcadero Road. Operating deficits in the first years of operations were added to the outstanding advance that was used to fund the initial construction at the Airport, and were expected to be repaid by future revenue.
Deloitte & Touche audit: In 1997, the City and County jointly funded a Deloitte & Touche audit of the County's financial statements for the Palo Alto Airport to settle questions about the appropriate accounting for Palo Alto Airport and the outstanding advance.

Proposed Airport business plan (Attachment 3): In FY 2005-06, the Airports Division[3] hired a consultant to update the 1982 Master Plan for the County's three airports, and prepare business plans for the three airports. The proposed Palo Alto Airport business plan recommends that the County terminate its involvement in the Airport after the lease expires in 2017. The recommendation is based on the premise that the Airport has historically operated at a deficit and that costs will continue to exceed revenues; that the loss of the Airport would not have any operational impact on the County system or its other two airports; and that future opportunities to generate additional revenues are extremely limited. The business plan further recommends that future capital investments be limited to those projects mandated and/or funded by the federal or state governments, and that the City should be required to provide any assurances that exceed the 2017 expiration date on the lease (i.e. the 20-year assurances needed for future airport improvement project grants). Finally, the proposed business plan recommends that the County raise tie-down fees to help make the Airport financially self-sustaining, and to help recover as much of the outstanding advance as possible prior to the lease expiration in 2017.

Proposed Airport Master Plan: The proposed Airport Master Plan identifies minor changes to the Airport's airfield area, and raises substantive questions about the extent to which the vacant 8-acre parcel fronting Embarcadero Road should be developed. City Planning staff

[3] The Airports Division is part of Santa Clara County's Roads and Airports Department.

indicates that improvements consistent with current Airport operations are within the scope of the City's Comprehensive Plan and the Baylands Master Plan. However, parts of the plan intensifying use or intruding into open space areas would not be consistent. A response letter from the Planning Director is attached (Attachment 2).

Purpose, Scope and Methodology: Because of Santa Clara County's recent release of a proposed business plan for the Airport, the Palo Alto City Auditor's Office was asked to review the Palo Alto Airport's financial statements, and evaluate the County's allocation of expenses and overhead to the Palo Alto Airport and the financial viability of the airport operations. We conducted our review in March and April 2006 in compliance with government auditing standards.[4]

DISCUSSION OF AUDIT RESULTS

The Palo Alto Airport has generated more than $400,000 in adjusted net income over the last 37 years. Table 1 summarizes the financial history of the Airport since 1969, including the County's more recent investments in the Airport's infrastructure (net of federal reimbursements). The County has used the Airport's adjusted net income to offset its original $1 million investment in start-up and capital costs at the Airport (the outstanding advance).

[4] For our review, we compiled the history of profits, losses and outstanding advances; reviewed the financial statements and accounting data provided by the County and City from 1969 to 2005; analyzed the method for assigning County costs and overhead to the three County airports; and compared the operating revenues, expenses, and income for the three County airports. We analyzed the depreciation schedules used by the County; performed a detailed review of the accounting records provided by the County for FY 2002-03, 2003-04, and 2004-05; reviewed the Airport and FBO leases and the joint agreement for the levee repaired by the County. We recalculated the direct and pooled charges assigned to the Palo Alto Airport and to the two other County airports; reviewed the proposed master and business plans for the Airport; and examined previous consultant reports and County-City agreements. We compared the proposed rate increases with the rates charged by other airports, and physically observed the operations at all the County airports. We interviewed County airport staff and executives, an Airport FBO executive, and representatives from the County Airport Land Use Commission, the County Airports Commission, and the Joint Community Relations Committee for the Palo Alto Airport (JCRC).

Table 1: Summary of Palo Alto Airport adjusted net income and outstanding advance

	Operating revenues[5]	Operating expenses (excluding depreciation)	Net non-operating revenue/expense (including capital)[6]	Adjusted net income		Outstanding advance (cumulative)
Prior						$1,085,134[7]
FY 1968-69	$61,830	($69,949)		($8,119)		1,093,253
FY 1969-70	63,786	(78,384)		(14,598)		1,107,851
FY 1970-71	78,636	(88,525)		(9,889)		1,117,740
FY 1971-72	93,338	(97,353)		(4,015)		1,121,755
FY 1972-73	100,961	(105,903)		(4,942)		1,126,697
FY 1973-74	103,152	(124,276)		(21,124)		1,147,821
FY 1974-75	115,493	(120,790)		(5,297)		1,153,118
FY 1975-76	119,201	(153,142)		(33,941)		1,187,059
FY 1976-77	135,612	(183,606)		(47,994)		1,235,053
FY 1977-78	152,571	(201,432)		(48,861)		1,283,914
FY 1978-79	176,944	(209,553)		(32,609)		1,316,523
FY 1979-80	197,881	(244,835)		(46,954)		1,363,477
FY 1980-81	231,470	(302,663)		(71,193)		1,434,670
FY 1981-82	288,678	(238,752)		49,926		1,384,744
FY 1982-83	313,807	(246,570)		67,237		1,317,507
FY 1993-84	346,267	(268,681)		77,586		1,239,921
FY 1984-85	343,626	(327,483)		16,143		1,223,778
FY 1985-86	369,880	(338,107)		31,773		1,192,005
FY 1986-87	364,268	(340,129)		24,139		1,167,866
FY 1987-88	366,968	(363,634)		3,334		1,164,532
FY 1988-89	392,868	(302,721)	(6,007)	84,140		1,080,392
FY 1989-90	378,027	(358,667)	5,358	24,718		1,055,674
FY 1990-91	397,788	(289,294)	(1,000)	107,494		948,180
FY 1991-92	426,542	(376,650)	47,863	97,755		850,425
FY 1992-93	505,306	(435,563)	27,864	97,607		752,818
FY 1993-94	430,105	(341,695)	19,578	107,988		644,830
FY 1994-95	385,542	(360,617)	26,871	51,796		593,034
FY 1995-96	438,722	(374,867)	27,964	91,819		501,215
FY 1996-97[8]	430,238	(381,060)	64,222	113,400		387,815
FY 1997-98	439,377	(473,818)	(15,785)	(50,226)		438,041
FY 1998-99	488,062	(548,411)	(26,112)	(86,461)		524,502
FY 1999-00[9]	474,680	(583,116)	(479,929)	(588,365)		1,112,867
FY 2000-01	647,857	(548,914)	(445)	98,498		1,014,369
FY 2001-02[10]	752,760	(834,677)	207,705	125,788		888,581
FY 2002-03	727,657	(663,106)	(649)	63,902		824,679
FY 2003-04	723,065	(617,646)	(1,166)	104,253		720,426
FY 2004-05	725,478	(735,448)	49,047	39,077		**$681,349**
TOTAL	**$12,788,443**	**($12,330,037)**	**($54,621)**	**$403,785**		

Source: Compiled by Palo Alto City Auditor's Office from various County reports

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[5] Does not include federal or state reimbursements for capital projects

[6] Data not available prior to 1989

[7] $2,186,793 in improvements, less $1,101,659 federal and state reimbursements

[8] Deloitte & Touche LLP audited the financial statements for the year ended June 30, 1997

[9] Includes $2.5 million improvements, less $2 million federal reimbursement

[10] Includes $204,539 prior year construction in progress reclassified to maintenance expense

County pooled and overhead charges now average more than 40% of Palo Alto Airport expense. The County charges some costs directly to the Airport, and allocates its pooled costs based on a formula. Over the last three years, the County's direct costs at the Palo Alto Airport averaged $391,791 per year.[11] As shown in Table 2, the County's pooled and overhead costs at the Palo Alto Airport averaged $280,561 per year – or about 41.7% of Palo Alto Airport operating expenses.[12]

Table 2: Percent County pooled and overhead expenses allocated to Palo Alto Airport

	FY 2002-03	FY 2003-04	FY 2004-05	*Average*
Direct County costs to operate Palo Alto Airport	$378,345	$360,744	$436,285	*$391,791*
Pooled County operating costs and overhead charged to the Palo Alto Airport	$284,761	$257,759	$299,163	*$280,561*
Total (not including depreciation)	$663,106	$618,503	$735,448	*$672,352*
Percent County pooled and overhead costs	*42.9%*	*41.7%*	*40.7%*	*41.7%*

Pooled County expenses for salaries, benefits, and general administration overhead have increased in recent years, reducing Palo Alto Airport operating income. For example, general and administrative County expenses increased 85.6%, from $94,031 in FY 1997-1998 to $174,533 in FY 2004-2005, and averaged $153,761 per year between FY 1997-98 to 2004-05. In contrast, direct Airport expenses for aviation services increased 45% from $81,766 in FY 1997-98 to $118,667 in FY 2004-05, for an average of $103,466 during the same period.

The County allocates pooled operating costs and overhead through a formula. The County allocates pooled costs to each airport according to a formula that uses four factors: (1) the number of operations staff, (2) aircraft operations (take-offs and landings), (3) aircraft based at the airport, and (4) number of principal tenants (or FBOs).[13] The percentages change each year as shown below:

Table 3: Percent of pooled County costs allocated to each airport

Airport	FY 2002-03	FY 2003-04	FY 2004-05
Palo Alto	32.5%	31.3%	31.3%
Reid-Hillview	58.6%	56.6%	56.6%
South County	8.9%	12.1%	12.1%

Allocated costs should be trued up at the end of each year. The County allocates pooled and overhead costs based on estimates. Actual percentages may vary. Using actual figures, we estimate Palo Alto paid almost $16,000 more than its share of allocated costs as follows:[14]

[11] Direct Airport costs included about $299,500 in salaries and benefits for 4.2 full-time equivalent employees at the Airport, and $136,000 in other direct costs. These employees staff the terminal at the airport. This does not include airport tower expenses which are borne entirely by the FAA.

[12] The Palo Alto Airport's share of pooled County costs and overhead included $125,500 in salaries and benefits, and $174,500 in insurance, professional services, internal departmental charges (e.g. legal expense), tools and instruments, transportation, and other general administration costs.

[13] The percentage of each factor for each airport is combined in an overall percentage that is used to allocate the pooled County expenses to each airport.

[14] In addition, County staff reports a credit of $53,728 will be issued in FY 2005-06 to reflect Palo Alto Airport's share of a $171,655 credit to adjust overhead rates applied to intra-departmental charges at all three County airports.

Table 4: Estimated versus actual pooled and overhead cost allocation percentages

	Estimated percentage	Actual percentage[15]	Amount overcharged
FY 2002-03	33%	32.5%	$2,588
FY 2003-04	33%	31.3%	$13,278
FY 2004-05	31.3%	31.3%	0
TOTAL	**-**	**-**	**$15,866**

If the Palo Alto Airport lease were terminated, the operating income for the remaining two County airports would be adversely affected. In FY 2004-05, Palo Alto paid $299,163, or 31.3%, of the County's pooled Airports Division operating costs and overhead. This included $125,000 in salaries and benefits for Airports Division employees, and about $174,500 in other general administration costs. Unless County expenses were reduced, the two remaining County airports would have to absorb some portion of Palo Alto's share of Airports Division expenses if the Palo Alto Airport lease were terminated. To illustrate, the Reid-Hillview and South County Airports would have had to absorb $245,000 and $55,000 in pooled and allocated costs, respectively, if the Palo Alto Airport had not contributed toward Airports Division expenses in FY 2004-05. County staff has indicated that County expenses would be dramatically reduced if the lease were terminated, offsetting the loss of revenue from Palo Alto.

Depreciation expense does not affect the outstanding advance. Although depreciation expense does not affect the County's annual calculation of the outstanding advance, it has sometimes been included in public discussion in a way that can mischaracterize the Airport's current cash flow position. The County's depreciation schedules amortize capital improvements and other projects completed at the Airport between 1966 and 2001. The schedules list improvements costing over $4,965,000, of which $3,383,000 was funded by Federal and State grants. Federal and State grants covered as much as 81% of the cost of some projects, and averaged over 68% of the total cost of all the projects.[16] Depreciation expense (including depreciation on projects funded by Federal and State grants) fluctuated from $417,321 to $184,426 to $312,974 in FY 2002-03, 2003-04, and 2004-05, respectively.[17] This can dramatically impact the appearance of profitability (or loss) at the Airport in any given year.

However, depreciation is not a flow of cash, and is irrelevant to the calculation of the outstanding advance. The County (correctly, in our opinion) does not include depreciation in its annual calculation of the outstanding advance. The outstanding advance is important because, in accordance with the lease, the County is to be repaid for its investment in the Airport, but must use any additional revenue to improve and maintain the Airport.

While the lease requires Airport revenues be reinvested in the Airport or applied against the outstanding advance, there is no formal loan agreement requiring repayment of the advance. The capital improvements and start-up costs for the Airport totaled over $2,187,000 in Federal, State and County funds. The County share of the start up costs, which totaled $1,085,134, was advanced by the General Fund to the Airport Enterprise

[15] County staff reports that the actual number of aircraft based at South County was significantly less than had been projected. If the County also makes that correction, it would increase Palo Alto and Reid-Hillview's share of costs, and reduce South County's share of costs. We agree that using the actual number of aircraft from the annual assessment roll is appropriate.

[16] As of June 30, 2005, the depreciation schedules listed $1,582,085 in County-funded facility improvements, with a book value of $377,601 net of accumulated depreciation.

[17] At that rate, the remaining $1,883,000 book value could be fully depreciated in 6 years.

Fund.[18] However, if the lease were to be terminated, there is, to our knowledge, no formal loan agreement for repaying the amount, and the City is not required to repay the outstanding advance to the County. As of June 30, 2005, the Outstanding Advance balance was $681,349, and the $403,785 in adjusted net income (shown in Table 1) remains in the Airport Enterprise Fund.

The outstanding advance amount is increased or decreased according to whether the Airport generates a profit or loss each year. No interest accrues on the balance. As shown earlier (in Table 1), after incurring losses in its start-up years, the Airport generated positive adjusted net income in 21 of the last 24 years (1982-2005). The Airport has reduced the outstanding advance by over $403,000. Losses in 1998-2000, which increased the outstanding advance after years of declines, were the result of $2.8 million in capital improvement projects.[19]

- *Embarcadero Road improvements in 1973 were charged to Airport users.* Our analysis of the outstanding advance indicated the County charged the Airport $194,500 for realigning Embarcadero Road and moving its related utilities. The Airport lease specifically states these were to be County expenses. It should be noted that the Embarcadero Road improvements benefited both the County-run yacht harbor and the County-run airport.

- *Levee repairs were charged to Airport users.* In FY 2005-06, levee maintenance and repairs totaling $125,454 (for construction contracts, consultant payments, and reimbursements for work done by the Roads Division) was charged to the Palo Alto Airport.[20] According to the 1979 agreement for maintenance of levees in the Baylands[21], the obligation to repair the levees appears to be an obligation of the County. The agreement does not mention the Palo Alto Airport. Therefore, the allocation of levee repair costs to Palo Alto Airport users may be questionable.[22]

Proposed tie-down fees would be significantly higher than nearby general aviation airports. The business plan proposes 30% tie-down fee increases at Palo Alto – compared to proposed 3% fee increases proposed at the other two County airports, Reid-Hillview and South County. This would put Palo Alto fees significantly above other nearby general aviation airports, and could jeopardize Palo Alto revenues if users chose to move their aircraft to other airports. Table 5 compares the present and proposed fees for aircraft tie-downs.

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[18] Under generally accepted governmental accounting standards, the advance would technically be considered a transfer, not a loan, since it has not been reported as an interfund receivable or payable.

[19] The county share of the $2.8 million in capital improvement projects was $550,900. Federal and State grants covered the remaining $2.3 million used for electrical rehabilitation and upgrades, slurry sealing the pavement, adding safety fencing, rehabilitating the apron, and repaving the runway.

[20] Up to $50,000 in additional expense incurred by the Santa Clara Valley Water District for the project is still pending.

[21] An agreement between the County of Santa Clara, the City of Palo Alto, and the Santa Clara Valley Water District.

[22] Apparently pedestrians have had access to the levee for many years, and the levee appears as part of the regional Bay Trail on the Bay Conservation and Development Commission's current maps. However, there does not appear to be any written agreement on the part of the City or the County for that access.

Table 5: Current versus proposed tie-down fees at nearby airports[23]

Airport	Current monthly tie-down fee[24]	Proposed monthly tie-down fee
Santa Clara County Airports		
Palo Alto	**$111.50**	**$144.95 (+30%)**
Reid-Hillview	$111.50	$114.85 (+3%)
South County	$79.50	$81.89 (+3%)
Nearby Airports		
San Carlos	$115.00	
Half Moon Bay	$59.00	
Hayward	$60.00	

Justification for increases: The business plan justifies the proposed fee increases by stating that the Palo Alto Airport has historically operated at a financial loss and that the deficits arising from operations at the Palo Alto Airport are being subsidized by surplus revenues generated by Reid-Hillview Airport. In our opinion, these statements mischaracterize the operating results of the Palo Alto Airport. As shown above, the Palo Alto Airport generated more than $400,000 in adjusted net income over the last 37 years, while covering a sizable share of countywide airport operations.[25] We estimate that if various adjustments to the outstanding advance were implemented (as discussed above), moderate fee increases were proposed, and operating and pooled costs were reviewed, the County's entire outstanding advance may be settled before the end of the lease without need for such dramatic increases in tie-down fees.[26]

Future viability of the Palo Alto Airport. Between now and 2017, the Airport should be able to continue to generate revenue sufficient to cover expenses and reduce the outstanding advance to zero (assuming that only modest capital improvements are needed in the next few years). In the recent past, the Airport has generated sufficient revenue to cover the required match for federal grants so that some of the modest improvements to taxi-ways and runway that are suggested in the master plan could be implemented. Moderate increases to user fees would help the cash flow picture without the need for the dramatic increase in the tie-down fee.

Increasing the number of hangar and tie-down spaces would generate additional revenues for the Palo Alto Airport in the near term. However, it is unlikely that major capital investments would happen prior to lease negotiations/expiration in 2017. Meanwhile, in the next 5-7

[23] Tie-down fees for comparable aircraft at the San Jose International Airport are $185.00 a month. However, San Jose is primarily a commercial airport and in a different category from the general aviation airports. Fees at Oakland (in the same category as San Jose) are $75.00 per month for comparable aircraft. San Jose is reducing space dedicated to general aviation. However, Oakland currently has space available.

[24] Tie-down fees for aircraft weighing 0 - 3,500 lbs.

[25] It should be noted that County staff expect the Palo Alto Airport to end FY 2005-06 at a loss, due to $125,500 in levee repair related expenses.

[26] Over the term of the lease, operating expenses have grown faster (an average of 7.9% per year) than operating revenues (an average of 7.6% per year). Airport expenses may be less than predicted for FY 2005-06 due to an unfilled vacancy, and staff is assessing the feasibility of curtailing terminal operating hours for FY 2006-07. Additional cost savings could result from reducing operating costs such as overtime ($22,600 in FY 2004-05), or contracting with one of the FBOs to provide terminal services (now performed by County staff at the County terminal). On the revenue side, a 3% tie-down fee increase would generate about $15,000 per year, compared to a moderate 10% fee increase generating about $48,000 per year, or about $145,000 per year generated from a 30% tie-down fee increase).

years, the advent of air taxi services and the introduction of very light jets (VLJ) capable of operating on short runways, could change the general aviation marketplace. Furthermore, actions by the San Francisquito Creek Joint Powers Authority, working with the Army Corps of Engineers to address flooding from the creek, could impact the Palo Alto Airport.

After 2017, FBO leases could generate higher revenues. Palo Alto Airport has two fixed base operators who have 30-year ground leases with the County. The leases allow the lessors to extend the original leases for additional 5-year periods until the County-City lease expires in 2017.[27] These leases did not contain clauses that based rent on inflation indexes such as the consumer price index, or require set dollar amounts for rent increases; and only one lease included a percentage of gross revenues generated from other sources. As a result, the lease revenues, which totaled $123,000 in FY 2003-04 and $131,000 in FY 2004-05, totaled only 17 to 18% of the total Airport revenues. Once the leases expire in 2017, these types of clauses could be incorporated into the lease terms to ensure higher revenues from lease rents.

Palo Alto is a regional resource: Our analysis indicates the Palo Alto Airport is truly a regional resource. Palo Alto residents compose only 23.3% (78 tenants) of the airport's 335 aircraft tenants.[28] Regional Civil Air Patrol and Stanford Life Flight operations use the Airport, along with flying clubs and other aviation-related tenants. According to the General Aviation Element of the Regional Airport System Plan, Palo Alto is one of 20 publicly owned and operated general aviation airports that provide services to personal and business aircraft owners and users. Palo Alto is designated by the FAA as a "reliever" airport, providing an important "safety valve" for activity that would otherwise consume runway and airspace needed by the airlines using the three major commercial airports.

The mission of the County's Airports Division is to *"promote the economic and social vitality of the County by meeting the needs of the General Aviation community and the traveling public."* Thirty-seven years ago, the City agreed to lease the Airport to the County for a nominal sum; the County agreed to operate the Airport and to maintain and invest in Airport facilities. During our review, City staff indicated that they expect and encourage the County to continue operating and maintaining the Airport until at least 2017.

Our recommendation is shown on page 2. I would like to express my appreciation to County and City staff for their cooperation and assistance during our review. A response from Santa Clara County's Director of Roads and Airports is attached (Attachment 1).

Respectfully submitted,

Sharon W. Erickson

Sharon W. Erickson, City Auditor

Audit staff: Edwin Young

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[27] The lease for one FBO (AMG) was signed in 1973 and assigned to another lessee in 1985. The original lease rent was $3,384 a year and, from the 11th year onwards, was set at 8.5% of the fair market value of the premises, excluding the buildings and improvements made by the FBO. The lease for the second FBO (Roy-Aero) was signed in 1969 and assigned to a replacement lessor in 1970. The original lease rent was $910 per month ($10,920 per year) and was also set at 8.5% of the fair market value of the premises from the 11th year forward, plus additional rent of 6% of the gross revenues derived from individual tenants who rented aircraft storage spaces known as "tie-downs".

[28] Statistics on transient and day-user aircraft are not readily available, and would require a manual count of County records.

ATTACHMENT 1
Response from Director Roads and Airports

County of Santa Clara

Roads and Airports Department

101 Skyport Drive
San Jose, California 95110-1302
(408) 573-2400

June 6, 2006

Ms. Sharon Winslow Erickson, City Auditor
City of Palo Alto
250 Hamilton Ave.
Palo Alto, CA 94301

Subj: Review of the Palo Alto Airport's Financial Condition

Dear Ms. Erickson,

Thank you for the opportunity to review the draft report regarding your analysis of the financial condition of Palo Alto Airport (PAO). The following comments are provided:

1) Operating income

The data presented support the County's conclusion stated in the draft Business Plan that since inception of the airport lease, the County's investment in the airport has exceeded net revenue by $681,000 despite the fact that the great majority of capital project costs have been funded by others and the fact that the County's unrecovered investment (the "Outstanding Advance") does not accrue interest. These facts are compelling indications of the financial subsidies required to operate the airport.

Nearly half of the meager $400,000 in total net operating income generated over the last 37 years will be wiped out by the projected FY 2006 operating loss, due in large part to the levee project. An operating loss is also projected for FY 2007. The record clearly demonstrates that operating profits generated in years when no additional capital investments were made are inevitably offset by the infusion of additional capital required to maintain and improve the airport. Because these additional investments do not occur every year, they tend to be overlooked by some even though they have the same effect, dollar for dollar, as an operating loss. The Outstanding Advance (OA) is quite handy in this regard as a metric of the airport's long-term financial performance because it represents the difference between the County's investment in the airport and the total net operating income.

2) Overhead

The overhead costs allocated to PAO are the overhead costs generated by PAO. These costs would not be incurred by the County if the County did not operate the airport and will be eliminated when the County ceases to operate the airport. Some costs, such as intra-departmental charges, County Counsel charges, insurance, etc. will shrink immediately upon expiration of the lease. Management staff costs will be reduced as the management structure is adjusted to reflect the reduced scope of responsibility. Any allocated overhead not eliminated as a result of the lease expiration would be small and offset many times over by the elimination of the business risk associated with running the airport.

It is important to note that no adjustment is made in the overhead allocation to reflect the additional administrative burden imposed on staff due to the lease arrangement with the City of Palo Alto, a burden which is not present with respect to the two airports owned and operated by the County.

3) Depreciation

We agree with the report's conclusion that the County is correctly excluding depreciation from the calculation of the Outstanding Advance, but not for the reason suggested i.e. because depreciation is not a cash transaction. Depreciation related to the grant-funded portion of capital projects is not included in the calculation of the OA because the OA is a benchmark of the County's financial exposure resulting from its involvement in the airport; the pass-through of outside grant funding does not impact the County's financial stake in the airport. The AEF-funded portion of capital projects is appropriately included in the calculation of the OA. In other words, the relevant issue is the source of capital that was used to fund the improvements being depreciated.

Depreciation is the mechanism by which costs for long-life assets are allocated over time and, of course, are entirely relevant to any discussion about the airport's financial position and performance. The fact that the County's investment in the airport has exceeded net revenue by $681,000 over 37 years (not including interest) despite the fact that the great majority of capital project costs were funded by others highlight's airport's reliance on subsidies to fund maintenance and improvements.

4) Embarcadero Road improvements and levee repairs

There seems to be continuing confusion over references to "County" expenses in the airport lease, with the implication that these expenses should somehow be funded by some County fund source other than the AEF. As we have discussed a number of times, the Airport Enterprise Fund is not a legal entity in and of itself and therefore cannot be a party to an agreement. The County of Santa Clara is the legal entity that is the party to agreements regardless of which County department or fund source is involved. The fact that the County – and not the Airport Enterprise Fund – is specified in the lease and the levee maintenance agreement as the responsible party for funding the Embarcadero Road improvements and the levee repairs, respectively, simply reflects this basic legal concept.

The report states that the Embarcadero Road improvements benefited both the Yacht Harbor and the airport but does not establish the basis to support this claim. The Yacht Harbor was accessed from Embarcadero Road prior to the improvements, so the improvements were not essential to provide access to the Yacht Harbor. The salient issue is that the Embarcadero Road improvements were made because they were required to be made by the airport lease. Since the improvements were performed to fulfill a requirement of the airport lease, it is entirely reasonable to conclude that the improvements would not have been made had the County not been a party to the lease. Therefore, even if the improvements provided some secondary benefit to the Yacht Harbor, it is appropriate that the full cost of the improvements be charged to the AEF. Finally, the 1998 Deloitte-Touche audit included the cost of the Embarcadero Road improvements in the calculation of the OA that both the City and the County agreed to use on a go-forward basis.

The same reasoning applies to the levee repairs. Because the County is a party to the levee maintenance agreement due solely to its involvement in the airport, it is appropriate that the County's costs of complying with the agreement be charged to the Airport Enterprise Fund. No case can be made to charge those costs to any other County fund source. Issues related to whether it is appropriate for the County to be a party to the levee maintenance agreement in the first place and how part of the leasehold came to be used for other purposes without the County's consent as required by the lease will be addressed under separate cover.

5) <u>Tiedown rates and the future viability of PAO</u>

The report does not provide any calculations to support the conclusion that the airport can generate sufficient revenue to cover expenses (including modest capital improvements) and reduce the OA to zero prior to expiration of the lease by implementing only small increases in tiedown fees.

No accounting adjustments to reduce the existing OA are warranted as discussed above, nor is there evidence presented that overhead costs are unreasonable, unnecessary or misallocated. As mentioned earlier, the OA is projected to increase substantially in FY 06 and FY 07 as escalation in operating costs outstrips growth in revenue. An increase in tiedown fees is the only viable opportunity to generate additional revenue.

The draft letter from the Director of Planning and Community Development attached to the report indicates that no increase in aircraft basing capacity or intensity of airport use will be allowed. The letter is troubling because Exhibit C to the lease sets forth the plan for development of the airport and shows hangars and a FBO on the parcel fronting Embarcadero Road. The adopted City policies referenced in the letter appear to unilaterally restrict the County's ability to develop the airport as agreed upon in the lease.

Thank you again for the opportunity to review and comment on your draft report.

Sincerely,

M.J. Murdter

Michael Murdter
Director

ATTACHMENT 2
Draft letter from Palo Alto's Director of Planning and Community Environment to Santa Clara County's Director Roads and Airports

DRAFT

April 24, 2006

Michael J. Murtder
Director, Roads & Airports
County of Santa Clara
101 Skyport Drive
San Jose, California 95110-1302

Dear Mr. Murdter:

This is in response to the County's Airport Master Plan for the Palo Alto Airport. The Master Plan provides long-range policies relative to the County's continued operation of the Palo Alto Airport. Physical or operational changes are governed by the City's Baylands Master Plan, which is attached for your future reference.

In general the City's Baylands Master Plan supports the continued operation of the airport in its current configuration. All aspects of the County's Master Plan related to the maintenance of the existing facilities as well as some of the proposed new construction activities are compatible with the City's plan. These include the additional aircraft wash rack, the replacement of the existing helipad with a new heliport, a new Taxiway D and reconfiguration of Taxiway G. The Baylands Master Plan, however, does not allow changes in airport activities that will increase the intensity of airport use or will significantly intrude into open space. Specifically, the expansion of permanent aircraft is in conflict with the Baylands Master Plan.

I hope this clarifies the application of existing City land use policies applicable to the Airport. Please feel free to contact me if you have any additional questions. I can be reached at steve.emslie@cityofpaloalto.org or 329-2354.

Very Truly Yours,

Steve Emslie
Director of Planning & Community Environment
City of Palo Alto

cc: Frank Benest, City Manager
City Council
JCRC

PAO Business Plan

INTRODUCTION

The Palo Alto Airport (PAO) Master Plan is part of an update to the 1982 Master Plan for the three general aviation airports in the County of Santa Clara. However, unlike the other two airports – Reid Hillview Airport and South County Airport – which are owned and operated by the County, PAO is owned by the City of Palo Alto but operated by the County pursuant to a 50-year lease executed in 1967 and expiring in 2017.

As the property owner, the City has sole discretion over the future of the airport. The Master Plan is an objective, stand-alone document that recognizes the City's sovereignty with respect to the airport regardless of whether the County is involved in its operation after 2017.

A companion document to the Palo Alto Airport Master Plan is this Business Plan, which addresses the County's future involvement in the operation of the airport. The Business Plan is a separate document because, unlike the Master Plan, it will be acted upon by the County Board of Supervisors.

This document:

- Presents an overview and analysis of the airport lease between the County and the City;
- Presents an overview of the Airport Enterprise Fund (AEF);
- Presents an overview and analysis of the airport's finances;
- Identifies the airport's future capital investment needs;
- Recommends County actions in anticipation of the City/County lease expiration in 2017.

City/County Lease Overview

Term & Rent

The lease specifies a term of 50 years and expires on June 11, 2017 according to City documents. The rent is $25 for the entire term of the lease.

Use and Development of Airport Real Property

The County's use of the leased premises is limited to constructing, operating and maintaining an airport and airport facilities; non-aviation industrial or manufacturing uses are prohibited. All improvements must conform to the City's building codes and are subject to City plan approval. A development plan was included as an exhibit to the original lease; execution of the development plan was contingent upon availability of funds and whether "the aviation needs and economic justification warrant such development." The development plan was subsequently modified twice and incorporated into the lease by lease amendment number one in October 1968 and amendment number two in December 1969. The City is required to support the County in all applications to financial assistance agencies concerning the development and operation of the airport.

The County is required to operate the airport in accordance with Federal Aviation Administration (FAA) regulations and has full power, authority and responsibility in regard to the operation, management and maintenance of the airport "as though it were the sole owner thereof."

The City is prohibited from entering into agreements, executing any leases or licenses, or granting any rights to the airport premises without the express written consent of the County. The City is required to prevent off-airport development from interfering with the airport safety zones.

In addition to the two lease amendments discussed above that incorporated the revised development plans into the lease, lease amendment number three in May 1980 established a requirement for the County to obtain City concurrence to apply to the FAA for approval of a second runway or expansion of permanent aircraft tiedowns above 510 spaces. The fourth and final amendment to the lease in 1983 clarified the County's responsibility with respect to utility charges related to the stormwater pumping plant.

Use of Revenue

Net operating revenue generated at the airport, if any, is first applied against the running balance of the County's unrecovered investment in the airport, which is termed the "Outstanding Advance." All remaining revenue, if any, is to be used for maintenance, operation or capital improvement of the airport premises. In other words, once sufficient net revenue has been generated to recoup the County's investment in the airport, any additional net revenue must be reinvested in the airport and cannot be used to fund operations or improvements at the other airports. The lease is silent with respect to whether the Outstanding Advance accrues interest.

Assignment and Subletting

The lease may not be assigned without the City's written consent but the County may sublet the premises without the City's consent.

Termination

The lease may be terminated by either party in the event of breach by the other party. The party in default has 30 days to remedy the breach from the date of notice by the other party. There is no provision for unilateral termination of the lease in the absence of a breach by the other party.

Summary

The lease clearly places all business risk related to operation of the airport on the County. The City has no financial obligation or risk with respect to the airport's operation. Moreover, if the County were to generate positive net operating revenue at the airport after recouping its initial investment, it must be reinvested in the airport and could not be exported to the other County airports.

AIRPORT ENTERPRISE FUND OVERVIEW

The Board adopted the following policy regarding the AEF:

> *"The Airport Enterprise Fund should be self-sustaining without subsidy from the General Fund. Revenue from fees and charges, state and federal grants and other sources should be sufficient to fund operating and maintenance costs, capital improvements and an appropriate level of reserves."*

Pursuant to Board policy, the AEF must pay for all costs – direct and indirect – associated with operating the airports, including costs for services received from other County departments. Some of these services are billed directly – for example, legal services are billed directly to the department based on County Counsel's established hourly rate. Other services such as Clerk of the Board costs for processing Board transmittals and providing staff support to the Airports Commission are distributed through the County Cost Plan. The AEF therefore provides full cost visibility for the myriad costs – some obvious and some not-so-obvious – incurred across the County to support the airports.

Although the AEF captures all airport finances in a single budget unit, the revenue and expenses associated with each of the three airports are tabulated for financial reporting and internal management accounting purposes. Revenue and expenses directly attributable to each airport such as FBO lease revenue, aircraft storage space rental revenue, operations staff salaries, etc. are easily identified. General and administrative expenses not attributable directly to an individual airport (insurance, management staff salaries, Cost Plan charges, etc.) are captured in an expense pool and prorated to each airport based on a weighted formula that uses cost drivers such as the number of based aircraft, number of aircraft operations and number of major facilities at each airport.

Total annual projected AEF revenue is approximately $3.2 million[1]; 76% of which is generated from County-owned aircraft storage spaces (i.e. hangars, shelters and tiedowns). Rental rates for County-owned aircraft storage spaces (hangars, tiedowns and shelters), fuel flowage fees and other airport-related fees are

[1] Including projected revenue from the 100 hangars nearing completion at South County Airport.

established through a Schedule of Fees and Charges approved by the Board of Supervisors by resolution.

The next largest revenue component (11%) is lease revenue from the 12 Fixed Base Operators[2] (FBO). Most of the FBO leases specify an annual ground rent equal to 8.5% of the fee simple value of the leasehold premises (not including improvements), and provide for adjustments every five years pursuant to a reappraisal of the premises. Given the long-term nature of the FBO leases, the revenue from this source is essentially fixed aside from the occasional minor adjustment to the lease rate (the reappraisal completed in December 2004 resulted in no rate increase). All other revenue categories including property rental, fuel flowage fees, transient aircraft fees and interest income collectively generate only 13% of AEF revenues.

Reid Hillview Airport (RHV) generates approximately 56% of the total AEF revenue primarily due to the income from the 145 County-owned hangars. Prior to the South County Airport (E16) hangar project currently nearing completion, it was the only one of the three airports to have County-owned hangars. Historically, RHV revenue has exceeded expenditures and the surplus has been used to subsidize operations at PAO and E16. Upon completion of the hangar project at E16, that airport will be financially self-sustaining.

PAO REVENUE AND EXPENDITURES

In November 1997, the City contracted with Deloitte & Touche (D&T), an independent auditing firm, to audit the County's financial data related to the airport and prepare a set of financial statements in response to concerns expressed by the Palo Alto Airport Association (PAAA) and the airport's Joint Community Relations Committee (JCRC) regarding the County's accounting for costs and revenues associated with PAO.[3]

The D&T audit, which was funded jointly by the City and the County at a total cost of $39,000, produced a set of baseline financial statements and alleviated the concerns raised by the PAAA and JCRC. Subsequently, County staff and City staff agreed on a format for the annual financial statements to be provided by the

[2] There are nine FBOs at RHV, two at PAO and one at E16.

[3] City Manager's Report CMR:371:97 to the Palo Alto City Council dated September 8, 1997.

County to the City. The attached draft financial statements for FY 2005 are typical of the data provided each year to the City.

Perhaps the best measure of the airport's long-term financial performance is the "Outstanding Advance", which is the difference between the County's total capital investment in the airport and the net revenue generated over the life of the lease. Additional County capital investment and/or net operating losses increase the Outstanding Advance; net operating profits decrease the Outstanding Advance. Since only the local (i.e. County-funded) component of capital projects adds to the Outstanding Advance, the Outstanding Advance serves as a benchmark of the County's financial exposure resulting from its involvement with the airport.

In the 38 years since inception of the lease, the County's investment in the airport has exceeded net revenue by $668,000. Fiscal Year 2006 revenue and expenditure figures indicate a projected net loss of $348,000, nearly half of which is due to a one-time expenditure for a levee maintenance project. Therefore, the Outstanding Advance is projected to grow to slightly over $1 million by the end of Fiscal Year 2006.

As mentioned earlier, the lease is silent as to whether the Outstanding Advance should accrue interest for accounting purposes given the lease requirement that any net revenue generated at the airport must stay at the airport once the County recoups its capital investment. As part of the D&T audit review, the County and City agreed that the Outstanding Advance (and any surplus, should one occur) would not accrue interest due to the lack of any language in the lease specifically addressing this issue. Therefore, the value of the Outstanding Advance does not reflect current dollars.

The fact that the Outstanding Advance does not accrue interest makes it all the more significant that the County's investments in the airport have not been recovered. At RHV and E16, capital investments financed by loans from the County General Fund or by revenue bonds accrue interest that must be paid for as part of the operating budget. If a similar scenario applied at PAO, the Outstanding Advance would be much higher.

The airport's projected FY 2006 revenue is $704,000 (approximately 22% of total AEF revenue) assuming that the airport remains near full capacity. Each revenue component and its dollar amount and percentage of total PAO revenue is as follows:

- **Tiedowns** - \$480,000 (68%). The County operates 362 of the 468 tiedown spaces at PAO[4]. Although demand for aircraft storage is projected to remain strong in the foreseeable future, the AEF's reliance on this revenue source makes it vulnerable to downturns in the general aviation market.

- **FBO lease revenue** – \$131,000 (19%). The ground rent paid by the two FBOs at the airport, Roy–Aero Enterprises LLC and Aviation Management Group, Inc. (AMG), is adjusted periodically pursuant to a reappraisal of the underlying land value as specified in the master leases. In 1994 Roy-Aero disputed the County's reappraisal and the matter was brought to binding arbitration. The arbitrator ruled that the FMV of the Roy-Aero leasehold should be discounted from the appraisal for the AMG and RHV FBOs due primarily to its flooding potential and soil conditions.

  At current annual rates of \$0.19/square foot (SF) (approximately \$8300/acre), the Roy-Aero lease generates ground rent of \$80,000 annually. The Roy-Aero lease also entitles the County to 6% of the FBO's revenue from certain hangars, which totals an additional \$25,000 per year. The current annual ground rent for the smaller AMG leasehold is \$0.2025/SF (approximately \$8800/acre), which generates \$26,000.

- **Fuel flowage fees** - \$50,000 (7%). The County collects a \$0.10 per gallon fuel flowage fee for all fuel dispensed at the County airports.

- **Transient Aircraft Revenue** - \$28,000 (4%). Transient aircraft (i.e. aircraft not based at PAO) are required to pay a fee when occupying a County tiedown. Certain tiedowns are designated for transient use.

- **Miscellaneous** – \$15,000 (2%). This category captures all revenue not attributable to one of the above categories, such as auto parking charges, etc.

Revenue generated at the airport from sales taxes and personal property taxes does not accrue to the AEF. City documents estimate these amounts as \$150,000 and \$200,000, respectively.

Projected FY 2006 expenditures total \$1,052,000, including \$170,000 for the aforementioned levee maintenance project. The AEF is experiencing a structural problem with respect to the airport's finances in that costs are rising while revenue is stagnant.

[4] All hangars at PAO are owned and operated by the FBOs.

FUTURE CAPITAL INVESTMENT NEEDS

This section briefly examines both grant-funded and locally-funded capital improvements identified in the Airfield Area and Building Area chapters of the Master Plan.

Currently, eligible projects selected for funding under the FAA Airport Improvement Program (AIP) receive 95% federal funding and qualify for an additional 4.5% state match from Caltrans Aeronautics, subject to availability of funds. Therefore, the local match required for AIP projects can be as low as 0.5%. However, the federal percentage is subject to change whenever the AIP is periodically reauthorized. Previously, the AIP provided 90% funding and there is the possibility that the program may revert to this funding level when the next reauthorization occurs.

The airport sponsor is responsible for 100% of the costs related to 1) the required match funding; 2) any element of the project ineligible for AIP funding; and 3) the difference between actual costs and estimated costs, which together can total a significant share of the overall project costs. For example, the total AEF funding component approached 20% of the $2.8 million capital project completed at PAO in 2001.

Airport Improvement Program grants are accompanied by a lengthy list of conditions ("grant assurances") that remain in force for 20 years. Some of the grant assurances relate to project implementation (consultant selection, prevailing wages, inspection, record keeping, etc.) while others are broader in scope, such as the requirement to keep the airport open for 20 years and the prohibition on diverting airport revenue to non-airport purposes.

The following projects identified in the Master Plan are eligible for AIP funding:

- New Taxiway D
- Reconfiguration of Taxiway G
- Heliport
- Aircraft washrack
- Physical security enhancements
- Airfield-related repair projects

The following development options identified in Chapter 4, Building Area, will require local funding:

- General Aviation Terminal Building replacement and parking lot
- Replacement tiedowns
- New hangars

Future County Involvement in Palo Alto Airport

Staff cannot identify a compelling reason for the County to assume the business risk of operating the airport beyond the expiration of its lease with the City in 2017 regardless of the changes to the lease that the City may be willing to make. Staff recommends terminating its involvement in the airport at the expiration of the City/County lease in 2017 to eliminate the possibility that RHV will need to subsidize PAO in the future and to allow staff to concentrate on executing the Master Plans for RHV and E16.

As noted earlier, the airport has historically operated at a deficit. However, future opportunities to generate additional revenue will be extremely limited. The airport is severely constrained from physical, environmental and policy standpoints; existing City policies specifically prohibit physical expansion of the airport into open space areas, significantly increasing the intensity of operations or adding a third FBO. In light of these constraints, only minor changes to the airport's airfield area were identified in the Master Plan. No change to the airport's role with respect to the type of aircraft to be accommodated is contemplated due to runway limitations. If a runway extension were feasible, it would have the potential to increase revenue by catering to corporate aircraft.

With respect to the airport's building area, the only possible area for additional revenue-generating development is on a portion of the vacant eight-acre parcel fronting Embarcadero Road. The City has the final say regarding the extent to which this parcel is developed, if at all. The only development option having revenue-generating potential that is identified in the draft Master Plan is the addition of 29 new hangars. However, skyrocketing construction costs, rising interest rates and the high cost of the likely mitigations required diminish the economic attractiveness of the project. Moreover, extremely stiff opposition to any development at the airport is virtually guaranteed and the approval process is anticipated to be lengthy, arduous and expensive.

Due to the nonstandard clearances between taxilanes and parked aircraft, any conversion of existing tiedown rows to T-hangars would result in a significant reduction of available aircraft basing capacity. Moreover, the economics of building hangars over tie-downs are inherently poor because the tie-downs that would be eliminated currently generate about one-quarter the revenue of hangars with no additional capital investment required.

As discussed in the Master Plan, the airport has an elevation of only 4 feet above mean sea level (MSL) and is located in FEMA-designated Special Flood Hazard Area. Therefore, as the existing airport building infrastructure reaches the end of its useful life and needs replacement, any new or substantially rebuilt airport structure such as a new Terminal Building must have its first floor raised above the 8-foot Base Flood Elevation (BFE) or be dry-floodproofed, which will add substantially to construction costs. The BFE for the airport is anticipated to rise upon conclusion of a FEMA study of the San Francisco Bay levee system. The higher the BFE, the higher the additional construction costs.

In addition, a large-scale project to improve flood protection to the City by raising the elevation of the existing levees surrounding the airport is inevitable and it is likely that the airport, as a beneficiary of the improvements, will be expected to pay a share of the project's construction and maintenance costs.

The basic business risk that costs could continue to exceed revenue over the long term could manifest itself in myriad ways. The airport could experience reduced demand from aircraft owners due to a downturn in general aviation caused by high fuel prices or some other factor. Although the Master Plan assumes that Moffett Federal Airfield will not become available for civilian general aviation use, the possibility exists that it could become available for such use, which would have a severe negative impact on the demand for PAO. Other possibilities include reduced federal grant revenue, unanticipated expenses or even a natural disaster such as a flood or earthquake.

The loss of PAO would not present any operational impacts to the County airport system because each airport's aeronautical activities are independent. Financially, eliminating PAO from the AEF would result in the loss of the airport's revenue, which would be more than offset by the reduction in direct operating costs, capital project expenditures and overhead costs. This would eliminate the possibility that RHV will need to subsidize PAO in the future and allow County airports staff to focus on executing the master plans for RHV and E16.

Regardless of whether the City operates the airport itself with City employees, hires a contractor to operate the airport on a day-to-day basis or leases the airport to a new lessee after 2017, the airport's structural financial problem and business risk must be addressed. Reallocating some of the business risk from the lessee to the City would help attract potential lessees but would not address the underlying problem. For example, if the City were to assume some risk by limiting the lessee's responsibility for certain costs such as capital investments, it may be possible to attract a lessee willing to pay rent but the overall risk would not change – it would merely be reallocated along with some of the compensation associated with said risk.

Operating costs could be lowered by hiring a contractor having lower labor and overhead costs than the County or the City to operate the airport on a day-to-day basis.

The City or a new lessee could take over the FBO facilities upon expiration of the FBO leases in order to generate revenue, particularly from the hangars. Both FBO leases expire simultaneously with the expiration of the City/County lease, and ownership of improvements constructed by the FBOs reverts to the airport sponsor upon expiration of the FBO leases. However, the revenue will be offset to some extent by the reinvestment required in the FBO facilities for maintenance, major repairs and code upgrades.

RECOMMENDED ACTIONS

The County should:

- Continue to fulfill its lease obligations until expiration of the lease with the City in 2017 but terminate its involvement in the airport at that time, or earlier if desired by the City.
- Limit future County capital investment in the airport to the local match necessary for essential, non-deferrable, AIP-eligible maintenance projects or security-related projects mandated by the FAA or Transportation Security Administration (TSA). Projects ineligible for AIP funding should not be undertaken.
- Require the City to submit all future AIP grant applications. Since the 20-year grant assurances will remain in force well beyond the expiration of the lease in 2017, the City must determine whether to apply for and accept the grants and thereby assume responsibility for the grant assurances after expiration of the lease.

  The County would retain full responsibility for compliance with the FAA grant assurances until expiration of the lease. The grant assurances relating to project implementation (consultant selection, construction contracts, wage rates, inspection, record keeping, environmental compliance, etc.)

will have been met by the County prior to expiration of the lease. Other assurances, such as the requirement to keep the airport open and the prohibition on exporting airport revenue, will remain operative for the entire 20-year life of the grant assurances.

- Raise tie-down rates to 1) help make the airport financially self-sustaining; and 2) help recover as much of the Outstanding Advance as possible prior to the lease expiration in 2017.