

Who's Got the Money?

Funding Growing Capital Programs in Lean Times

By Julian P. Andrews

Throughout the second half of the 1990s, sustained passenger growth highlighted the need for significant capital investment in national aviation infrastructure, a need that was reflected in the substantial increases in AIP grants authorized under AIR-21. As we approach FAA funding reauthorization this year, the outlook for the industry could not be more different from that of 1998.

Terrorism, reduced economic growth and declining or stagnant passenger numbers, coupled with increasing federal and state budget deficits, have squeezed airport budgets from all sides. However, the need for capital investment remains as strong as ever. Recent testimony before the Senate Aviation Subcommittee has estimated required capital spending of up to \$15 billion per year over the next four years, up from an average of \$12 billion per year between 1999 and 2001 — continuation of current levels of funding could result in an annual system-wide deficit of up to \$3 billion per year.¹ Furthermore, terminal modifications needed to accommodate new security equipment and procedures are estimated to cost an additional \$2.3 billion.²

As Congress considers the upcoming FAA funding reauthorization bill, in this *Measure of the Month* we examine how airports' capital spending (CAPEX) has changed since the peaks in passenger enplanements (EPAX) of 1999-2000 and the implications for funding future capital programs.

Capital Investment Continues to Grow

Contrary to early predictions of significant declines in airport capital spending after the terrorist attacks of 9/11, and

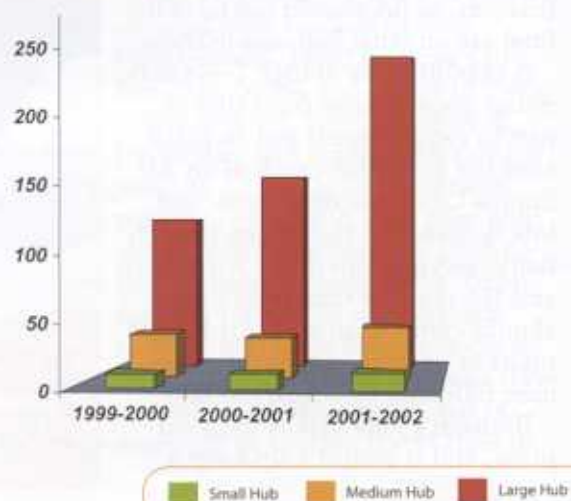
notwithstanding the delay of several high-profile projects, recent data indicates that, overall, airport CAPEX is continuing to grow on the trajectory set in the late 1990s. Data from the 1999-2001 AAAE *Rates and Charges Survey* show that, on average, large hub airports spent \$124 million annually on capital projects, medium hubs \$34 million and small hubs \$11 million.³ Corresponding data collected in the 2001-2002 AAAE *Rates and Charges Survey* shows substantial increases in these spending levels. The 2001-2002 survey was conducted in the first quarter of this year and primarily reflects activity since 9/11. Information was received from over 340 airports, including 29 large hub, 22 medium hub, and 51 small hub airports. As shown in Figure 1 (Fig. 1), the average annual CAPEX reported by airports has increased over the three years between these surveys, with small hubs reporting an average increase of 21 percent, medium hubs

17 percent and, most significantly, an average increase of 110 percent among large hub airports.

Of course, much of the capital spending in this period was programmed prior to 9/11 and the recent economic slowdown and is, in essence, providing the infrastructure for the passenger growth of the late 1990s. However, the survey data suggest that these levels of capital spending are likely to continue over the next several years. The five-year capital plans reported by airports in the survey show that average annual CAPEX will remain at levels similar to those of the 2001-2002 period for both large and small hubs at \$260 million per year and \$10 million per year, respectively. Medium hubs' spending is planned to increase a further 50 percent to \$60 million annually.

These figures beg the question, how have airports funded these growing capital programs during a very difficult period for the aviation industry and will they be able to continue to do so?

Fig. 1 AVERAGE ANNUAL CAPEX BY SIZE (\$MILLIONS)



Recent Growth in CAPEX Funded Largely by Debt

Historically, airports have relied on three major sources of funding for their capital program: issuing bonds, federal grants (including AIP) and passenger facility charges (PFCs). Bonds are secured primarily by general airport revenues, yet also may be supported by AIP Letters of Intent, PFCs and, in some cases, general obligations of the cities or regions in which they are located. On average, from 1999 – 2001, bond issues funded 59 percent of CAPEX, AIP grants 21 percent and PFCs 13 percent.⁴

Of these sources, bonds had the greatest flexibility to respond to changes in capital needs. AIP grants are limited by legislative authorization and recently have been diverted to help meet new security requirements. Indeed, in FY2002 the FAA awarded \$561 million of AIP grant funds to security related projects, thereby reducing the level of federal funding available for non-security projects.⁵ This amount represented 17 percent of the total value of AIP grants available in FY2002, an increase of over \$500 million on similar grants in FY2001. Growth in PFC revenues is largely limited by growth in passenger levels and the current \$4.50 per EPAX FAA limit. Therefore, with the declines in traffic we have seen in recent times, it is not surprising to see that airports have turned to bonds to fund increasing capital needs. This is clearly demonstrated in Table 1, which shows significant increases in the average level of the total debt outstanding of the sample airports.

TABLE 1: AVERAGE TOTAL DEBT OUTSTANDING

\$ millions	1999 -2000	2001 -2002	Percentage Increase
LARGE HUBS	1,003	1,478	47%
MEDIUM HUBS	242	297	23%
SMALL HUBS	33	45	35%

Can Debt Continue to Fill Funding Shortfalls?


Given the level of capital investment needs that have been forecast for the next five years, it is worth examining whether the continuing use of debt is a sustainable solution to future funding shortfalls. To answer this question we estimated the average airport debt capacity⁶ and compared it against the average actual debt outstanding to determine airports ability to continue issuing debt. The results of this analysis are presented in Fig. 2.

As can be seen, large and medium hub airports in our sample are fast approaching the limits of their estimated debt capacity, with 84 percent and 83 percent utilization, respectively. Small hub airports have greater, although still limited, flexibility at 67 percent utilization. Clearly, under current conditions airports are likely to find it increasingly difficult and expensive to raise capital funds through traditional bond issues.

Other Funding Sources

Airport capital spending has continued to increase over the last three years. As this growth has outpaced the growth in both government funding and PFC revenues, airports are becoming more and more highly leveraged as they issue debt to support expanding capital programs. As a result, many airports are beginning to reach the limit of their debt-carrying capacity. To pay for planned capital programs, airports will need to find ways to both increase their operating margins and identify additional revenue sources.

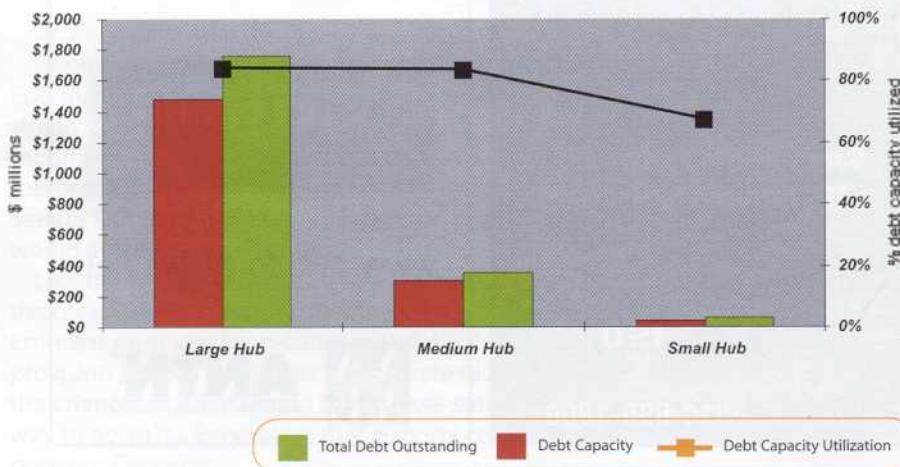
Increasing operating margins will require exploiting opportunities in new concessions, IT-related initiatives and land development. Airports will need to focus on efforts to improve efficiency, increase staff productivity and reduce the administrative burden of airport operations.

Airports must also look to grow new revenue sources. For example, requiring the TSA and FAA to pay commercial rates for the floor space they use will both increase revenues and eliminate a hidden subsidy. In addition, the revenue potential of the PFC program has not been fully tapped. To date, only 55 percent of large hub and 30 percent of medium hub airports charge the maximum of \$4.50. Further, three large hub and six medium hub airports do not have PFCs. 

How does this experience compare to your airport? If you would like to share your ideas and information, please e-mail jandrews@imggroup.com.

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Fig. 2 TOTAL DEBT OUTSTANDING, CAPACITY AND UTILIZATION BY SIZE



1. Gerald L. Dillingham, Director, Civil Aviation Issues, General Accounting Office, Testimony before the Subcommittee on Aviation, Senate Committee on Commerce, Science, and Transportation, February 25, 2003

2. US Department of Transportation, Budget for Fiscal Year 2003

3. Airport classifications are based on FAA criteria of enplaned passengers of > 6.6 million for large hubs, between 6.6 and 1.7 million, and between 1.7 million and 300,000 for small hubs.

4. Dillingham, *ibid*.

5. US General Accounting Office, *Airport finance: Using airport grant funds for security projects has affected some development projects*, Report to the Committee on Transportation and Infrastructure, House of Representatives, October, 2002.

6. Debt capacity is based on operating income as reported in the 2001-2002 Survey and assumes a term of 30 years, coupon of 6% and a minimum debt service coverage of 1.25X.