# Session 13 – Agreements with Airlines and Other Commercial Users

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Desk Reference Chapters 5, 27

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# Session Overview

- Basics!
- Generalities
- A lot to cover and WAY too many slides, BUT…
- Questions & Discussions welcome!
- Goal is to give you a good working knowledge & overview of the topic

# Session Overview

- Introduction to Applicable Grant Assurances
- Application of Grant Assurances to Airport Agreements
- Title VI
- Non Use & Lease Agreements
- Airport Legal/Financial Framework
- Building Blocks for Agreement
- Airport-Airline Business Relationship
- Airline Agreements
  - Ratemaking Methodology
  - Facility Management Provisions
  - Capital Project Consultation
- Other Considerations
  - Affiliate Airlines
  - Environmental
  - Insurance
  - Bankruptcy

# Federal Regulation

- Surplus Property
  - Public Law 289; Title 49 USC (47151- 47153)
  - Federal interest transferred to local public agency. Deed or agreement contains restrictions to protect the interests of aviation
  - The land generally must be used for airport purposes (some land may be used for non-aviation revenue producing purposes; land determined not to be needed for airport purposes may be sold for FMV, reversion clause).
  - Key: Read the deed or agreement!

# Federal Regulation, cont.

- Section 16/23 Land Conveyance
  – Conveyances of U.S. Government Land (Sec. 16/23; Title 49 USC 47125)
  – Conveyed to local public agency solely for airport purposes.
  – Land may not be sold.
  – Ownership reverts back to the U.S. Government if land is not needed for airport purposes.
  – Key: Read the deed!

# Grant Assurances

- Applies to agreements on and after September 2, 1982 (Start of AIP)
  - Grant Assurance 5: Preserving Rights and Powers
  - Grant Assurance 19: Operation and Maintenance
  - Grant Assurance 20: Hazard Removal and Mitigation
  - Grant Assurance 21: Compatible Land Use
  - Grant Assurance 22: Economic Nondiscrimination (Aeronautical Only)
  - Grant Assurance 23: Exclusive Rights (Aeronautical Only)
  - Grant Assurance 24: Fee and Rental Structure
  - Grant Assurance 25: Airport Revenues
  - Grant Assurance 29: Airport Layout Plan
  - Grant Assurance 31: Disposal of Land

# Non-aeronautical Lease Agreements

- Perhaps the most sticky area
- The grant assurances in and of themselves, do not prohibit an airport owner from using airport property for non-aeronautical revenue production.
- Note that some Surplus Property Deed Restrictions and Sec. 16/23 conveyances do prohibit non-aeronautical use.

- FAA says…. for non-aeronautical uses the FAA requires:
  - The airport receive FMV rents,
  - The airport owner demonstrate that all aeronautical uses have been accommodated and that any future aeronautical users can be reasonably accommodated.
  - –The sponsor include provisions in interim–use agreements requiring the leasehold to revert back to the sponsor in the event that it is needed for aeronautical development ("clawback").
  - The land in question is shown as non-aeronautical on the Airport Layout Plan (ALP).
  - FAA concurrence

# Non-aeronautical Lease Agreements

- Landmines
  - Non-Aeronautical uses of airport property that is not depicted on ALP.
  - Overly long lease terms excessively (generally 50 Years Max.) Useful life of improvements (Rights & powers, disposal of property)
  - Below FMV lease rates  or rates that are not sufficient to recover the cost to operate and maintain the airport, based on the circumstances at the airport (self sustainability)
  - Absence of escalation clauses (self sustainability)
  - Absense of reversionary clauses or clauses that require removal of obsolete improvements upon expiration of the lease (rights and powers, self sustainability)
  - Airport resources used to support the non-aeronautical activities in the absence of a means for the airport to recover these costs. (ex. maintenance, support services (trash and snow removal)

# Aeronautical Lease Agreements

- Rates may be below fair market value BUT…
- Obligation is to make the Airport as self-sustaining as possible (Recovery of Sponsors cost to operate and maintain the airport; Consistent with Policy Regarding Airport Rates and Charges)
- The agreements cannon be unjustly discriminatory
- Sponsors can make reasonable distinctions between airport tenants with regard to lease terms (including lease rates)
- No exclusive rights
- Lease must be subordinate to in incorporate Federal obligations, including the grant assurances

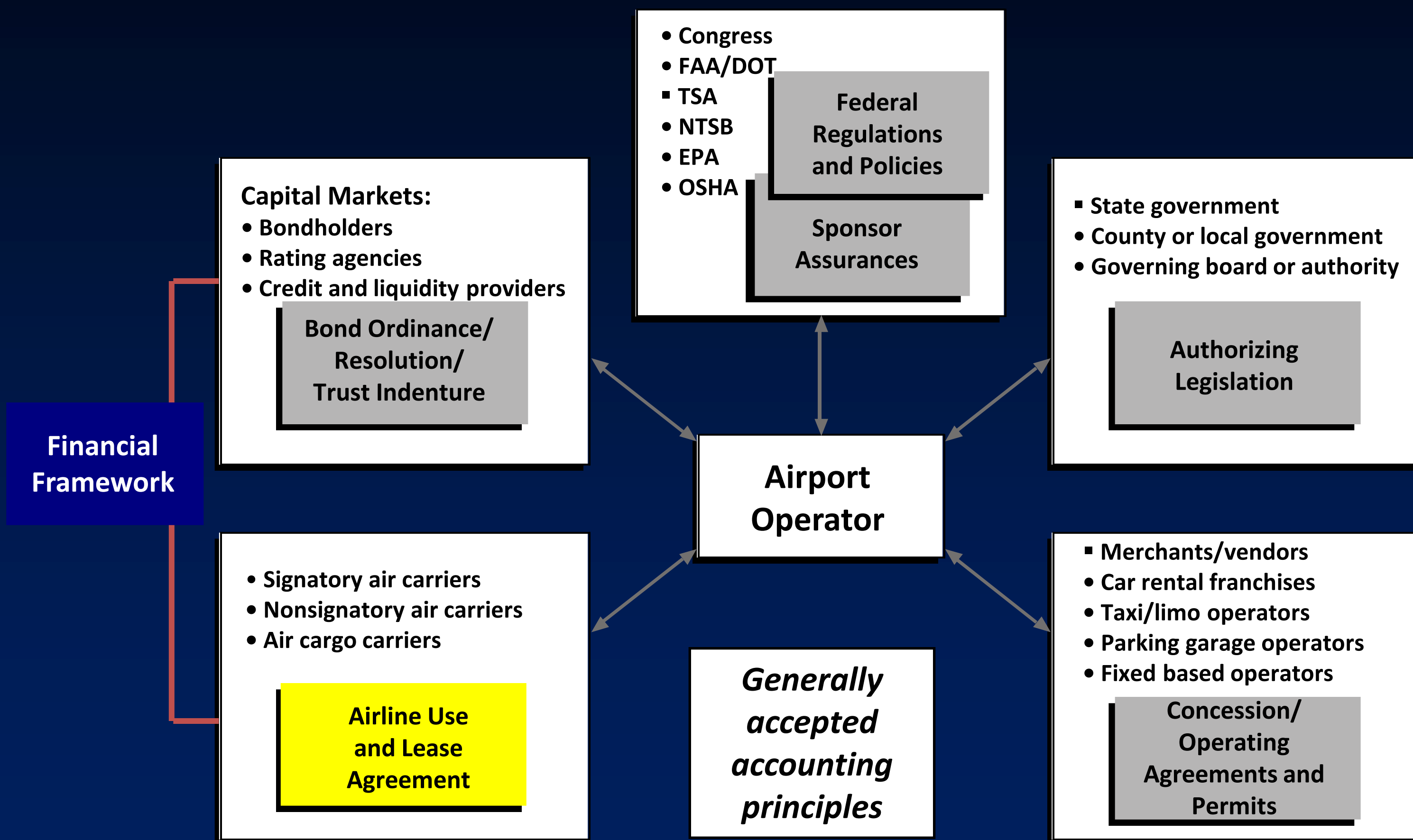
# Airline Use & Lease Agreements

- The biggie at most airports
- High stakes, long term impact
- Affects every aspect of the airport
- This part of session will only take 3 more hours
- Lunch will be brought in

# Preview of what is ahead

- Three classifications of Airline Operating Agreements
  - Residual
  - Compensatory
  - Hybrid
- First discuss common elements

# Airport Legal/Financial Framework



# Understand Your Playing Field

- **Limitations:** what are your fixed elements? *i.e.* those things that you can't change
- **Legal:** Federal Law, Bond Ordinances, Existing Agreements
- **Physical:** Built space, projects under construction. Survey "rentable space" and needs of airlines.
- **Financial:** Flow of funds, PFCs, Debt Service, Bond Reserves, Bond Covenants

# Building Blocks for Agreement

- Cost centers
- Cost center allocations
- Terminal space inventory
- Capital program and sources of funding

# Typical Airport Cost Centers

| Cost Center | Spaces Included |
|---|---|
| Terminal | Passenger terminal buildings, baggage claim, loading bridges |
| Other Buildings & Grounds | Airline and GA hangars, fueling facilities, other land/building leases |
| Cargo | Airline freight, express, and mail handling facilities |
| Airfield | Areas for aircraft landing, taking-off, taxiing, safety areas, and parking; terminal and cargo apron areas |
| Parking & Roadways | Short term, long term, and shuttle parking areas; rental car facilities; airport access roads |
| Reliever Airport | General aviation reliever |
| *General & Administrative* | *Indirect expenses allocated to other cost centers* |

Building Blocks for Agreement

# Cost Center Allocations

DOT Policy requires cost allocations to be reasonable and transparent

## What are you allocating?

- Operating
  - O&M expenses
  - Equipment and capital outlays
  - Bad debt, assessments, settlements, judgments
- Capital
  - Debt service and coverage
  - Amortization of investments
  - Net of grants and PFCs
- Reserves
  - Debt service
  - O&M
  - Renewal & replacement

## How are you allocating it?

- Ensure cost recovery
- Connect charges with use
- Basis for allocating costs
  - Activity
  - Accounting system with time card records or work orders
  - . . . or management judgment
- Allocating indirect expenses
  - Direct expenses
  - 50% revenues/ 50% direct expenses
  - Negotiated percentages
  - . . . or management judgment

# Understand Your Cost Centers

## AIRLINE

- Airfield Area
- Terminal Complex
  - – Ticket Counters
  - – International Facilities
  - – Baggage Claim
  - – Baggage System
    - Airport Owned?
    - Airline Owned?
    - Conventional
    - Automated
  - – Transit System/People Mover
  - – Airline Tenant Finishes and Equipment
    - Landside Terminal
    - Loading bridges
      - – Airport vs. Airline owned
  - – Concourse Ramp Area
  - – Fueling System

## NON-AIRLINE

- Rental Car Facilities
- Concessions
- Public Parking Area
- Employee Parking Area
- Commercial Vehicle Facilities
- Cargo Area
- Airline Maintenance/Support Areas
- Tenant Leased Land
- Airport Maintenance
- General Aviation
- Airport Mail Facility
- Snow Equipment

# Airport-Airline Business Relationship

## BILATERAL

- Negotiated with airlines
- Airfield operating agreement and terminal lease
- Combined “use and lease” agreement
- Passenger airlines vs. cargo carriers

## UNILATERAL

- Established through consultation
- Ordinance and regulations
- Permits and regulations

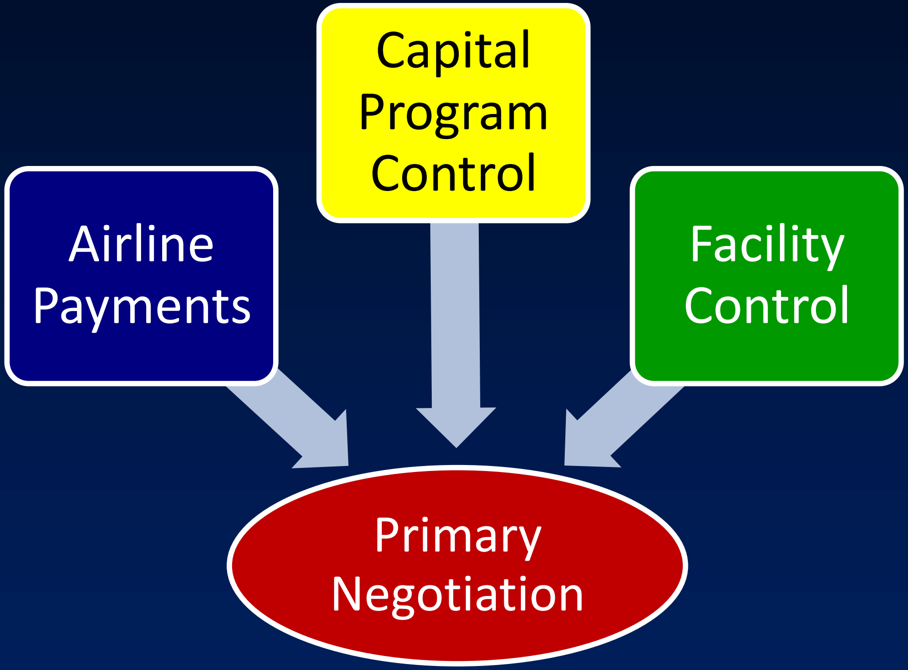
No airline agreement is required.
Some airports operate without an agreement

# Rates by Ordinance

- Without an airline agreement, airline fees set by rate ordinance, resolution, regulation, or tariff
- Governed by DOT Rates and Charges Policy and case law
- Endeavor to be self-sustaining
- Rates are “reasonable” and not “unjustly discriminatory”
- Airport proprietor may not require airlines to cover losses generated by non-aeronautical facilities
- Cost allocation must comply with DOT rules, for example:
  - Aeronautical users shouldn’t pay costs properly allocable to other users or groups
  - Aeronautical cost-based fees may not exceed the costs properly allocated to those users
  - Roadway costs can be allocated back to other cost centers

# Airline Agreements

- Establish what airlines can do at airport and what airport is obliged to do for airlines
- Airline payments
  - Costs in rate base and cost center structure
  - Rents, fees, and charges calculation methodologies
- Airline role in capital decisions and consultation
- Control over and use of gates and facilities
- Other provisions: affiliates, insurance, environmental, etc.



# Balancing Airport and Airline Objectives

| | Airport Objectives | Compromise | Airline Objectives |
|---|---|---|---|
| AIRLINE PAYMENTS | Recover all costs | Trend toward compensatory agreements | Stabilize rates<br>Establish rates by formula |
| | Generate adequate discretionary cash flow | Financial incentives for cost control | Minimize costs |
| | Provide adequate reserves<br>Meet debt obligations<br>Minimize bankruptcy risk | Extraordinary coverage protection | Avoid paying costs of others |

Airport-Airline Business Relationship

# Balancing Airport and Airline Objectives

| | Airport Objectives | Compromise | Airline Objectives |
|---|---|---|---|
| CAPITAL | Control over capital improvements (no MII) | Triggers for capital construction | Control over capital improvements (strong MII) |
| FACILITY | Control over facilities (common use) | Preferential use with accommodation and recapture provisions | Control over facilities (exclusive use) |
| OTHER | Promote air service Attract new entrants | Equitable treatment of all airlines | Preferential treatment of incumbents |
| OTHER | Historical agreement and relationships | Identify needed changes | Historical agreement and relationships |

# The core driver in airline negotiation

- Cost Per Emplaned Passenger (“CPE”)
- CPE represents the aggregate cost per passenger at a given airport
- How expensive is it to service the airport
- Total Costs – Revenues = Net Cost / # PAX
- Note inverse relationship between passengers and CPE

# Rates & Charges Methodology

| | |
|---|---|
| **Residual** | ▪ Recover net costs after credit of nonairline revenues<br>▪ Financial risk transferred to airlines<br>▪ Usually requires airline approval on capital investment decisions<br>▪ Limited accumulation of airport equity |
| **Compensatory** | ▪ Recover only those costs allocated to occupied facilities<br>▪ Airport assumes financial risk<br>▪ Only pay for what you use<br>▪ Airport keeps nonairline revenues |
| **Hybrids** | ▪ Mixture of both methodologies<br>▪ Balance of risk and facility control<br>▪ Carve outs of self-supporting cost centers<br>▪ Net revenue-sharing formulas (usually in return for “safety nets”) |

# Methodology and Nature Related

| Pure Residual | Modified Residual | Modified Compensatory | Pure Compensatory |
|---|---|---|---|
| • Ft. Lauderdale<br>• Pittsburgh | • Orlando<br>• Dallas/Ft. Worth<br>• Philadelphia | • Colorado Springs<br>• Manchester-Boston<br>• Baltimore/Washington<br>• Albuquerque | • Boston<br>• Los Angeles (LAX)<br>• Kansas City |

| **Strong Airline** | **Comprehensive Agreement; Shared Control** | **Differential Facilities Sub-sets** | **Strong Landlord** |
|---|---|---|---|
| • Comprehensive contract regarding:<br>– Rate-setting in multiple activity centers<br>– Capital projects<br>– Debt issuance | • Rate setting contract governs application of “surplus” funds; multiple cost centers<br>• Contractual definition of cost centers<br>• Airline voting on capital projects | • Commercial real estate approach<br>• Leases for preferential and common areas with rate-setting guidelines<br>• Limited review of capital projects | • No master contract<br>• All rates by ordinance<br>• Tenants-at-will for occupied premises |

# Trends

- Away from residual cost rate-making toward compensatory and hybrid methods
- Increased use of “activity-based” rates
- Establishment of cost recovery security fees (security checkpoint, EDS space, exit lane staffing, etc.)

# Capital Project Control

- Airline approval/disapproval rights vary:
  - None
  - Airport doing project at all
  - Including project costs in airline rates and charges
  - Issuing bonds for project
  - Certain types of projects
- Many airports have obtained “pre-approval” for capital programs in their agreements
- Majority-in-interest (MII) of airlines represent a majority of passengers, landed weight, or payments to airport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# Facility Control

- What rights do airlines have to space they lease?

| Lease type | Description | Example types of space |
|---|---|---|
| Exclusive | Exclusive right to use | Ticket counter, back office, clubrooms |
| Preferential | First right, airport may assign others if not in use | Gates, holdrooms |
| Joint | Used by many airlines | Bag claim areas |
| Common | Airport assigns | Circulation, restrooms |

# Understand Your Facility

- Types of Space – from Public to Private
- Terminal:
  - **Public Areas:**
  - **Common Use or joint use:** Costs that can be prorated according to amount of use (# of bags or passengers).
  - **Preferential Use:** Airline has right of first use but may have to share. Airport retains right to allow other airlines to use the area "to the extent such other use does not infringe on the Airline's preferential use as herein defined."
  - **Exclusive Use:** Traditional leasehold areas that are exclusively used by the Airline.



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## Facility Control

# Use-It-or-Lose-It and Accommodation

- If an airline isn't using the space efficiently and someone else needs it, airport can take it back
- Thresholds in airline agreements range from:
  - Ex. 3 to 7 turns per gate per day
  - Airport-wide average utilization
- Primarily applies to gates, but some agreements have similar provisions for ticket counters and associated office space
- Accommodation provisions
  - Ability to reallocate space at select intervals
  - Ability to force sharing
- A Note About **Competition Plans**, PFCs and Grant Assurances

Facility Control

# Trends

- Recent agreements trend toward preferential use
  - Optimize facility use and reduce capital needs
  - PFC funds only for preferential/common use space or exclusive use space with lease less than 5-years
- Preserving the flexibility to reallocate or reassign exclusive use space to accommodate changing mix of airlines and market shares
- Move toward common use terminal systems

# Affiliate Airlines

- Affiliate definitions include:
  - Wholly-owned subsidiaries
  - All seats sold in the name of signatory airline
  - Operates under the same trade name and uses essentially the same livery
  - Airlines with a code sharing agreement
- Typically require affiliates and signatory to formally declare relationship
- Affiliates typically do not sign the airline agreement

Other Considerations

# Environmental & Insurance

- Often most time-consuming section of airline agreement to negotiate
- Establishes:
  - Types and amounts of insurance airlines must have to operate at Airport
  - Indemnity provisions – a VERY important risk-containment method for airports
  - Environmental procedures, audits, and compliance
- Not only negotiating with airline property reps, but their legal counsel as well

Other Considerations

# Airline Bankruptcy

- Airline Bankruptcies Have Become A Regular Occurrence in Post 9-11 Era
- Hope for best, but plan for worst
- Impact of Bankruptcies and Airline consolidation over past 10 years
- Crystal Ball says….

# Honorable Mention: Title VI

- Certain language MUST be included in ALL contracts
- FAA issued document identifying what needs to be in what
- Not always clear as to what to include

# Questions?

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