County of Santa Clara
Roads and Airports Department

92111

DATE: September 17, 2018

TO: Housing, Land Use, Environment, and Transportation Committee (HLUET)

FROM: Harry Freitas, Director, Roads and Airports

SUBJECT: Airports Business Plan Supplemental Report

RECOMMENDED ACTION

Receive report from Roads and Airports Department relating to Airports Business Plan Update.

FISCAL IMPLICATIONS

The Business Plan update sets out a series of policy options with a recommended course of action. The airport system operates through a self-funded Enterprise Fund. Adoption of the Staff Recommendation does not impact the General Fund.

REASONS FOR RECOMMENDATION

The purpose of this report is to provide additional information to the Housing, Land Use, Environment, and Transportation (HLUET) Committee for consideration related to the County Airports Business Plan Update and to receive input from the HLUET Committee regarding the proposed recommendations the staff will present to the Board of Supervisors at a subsequent meeting.

At its December 12, 2017 meeting, the Board of Supervisors directed staff to proceed with the update to the Business Plan for Reid-Hillview Airport and San Martin Airport.

Staff has prepared a draft Business Plan Update for HLUET and the Board's consideration. As indicated in the attached draft Business Plan Update, key components and goals of the Business Plan Update's analysis included:

- Analyzing the Airport Enterprise Fund's (AEF) and the individual airports' sources of revenue and types of expenses;

- Identifying trends in the piston-propeller segment of General Aviation and their effect on the type of operations occurring at the County airports as well as their effect on the AEF's longstanding Business Model;

- Developing Long Range Facility Plans (LRFPs) that identify the airports' maintenance and capital improvement needs and their associated costs;

- Developing a new Business Model for the County airports necessitated by the changing nature of the airports' operations;

- Outlining the actions needed to execute the new Business Model and the estimated potential revenue to be realized; and

- Examining the historical role of grant funding from the federal Airport Improvement Program (AIP) with respect to development of the airports and the appropriate role of AIP grants going forward.

<u>The analysis described above produced the following key conclusions:</u>

- The AEF's longstanding Business Model has relied on revenue from aircraft storage spaces (hangars, tie-downs and shelters) for over 75% of total revenue. This Business Model has enabled the AEF to remain financially self-sustaining for many years. Operating revenue has been sufficient to fund operating expenses, although the condition of both airports could be characterized as run-down, as well as the local match required for grant-funded capital projects, which have been implemented on a pay-as-you-go basis.

- However, the piston-propeller segment of General Aviation is in decline, which has negative repercussions on the financial health related to the ongoing operational and maintenance expenses of the airport system and its ability to remain financially self-sustaining with revenue primarily from aircraft storage. Notwithstanding the decline in based aircraft, the number of operations at the County airports in the last several years has been growing due to the demand for professional pilots and the associated flight schools required to train them. These trends dictate that the County change its longstanding business model to one with a more diversified and higher-yielding revenue stream.

- The key to generating a more diversified and higher-yielding ongoing revenue stream is to put the airports' real property assets to work by leasing certain parcels for non-aviation commercial development and by restructuring the Fixed Based Operator leaseholds.

- The airports' infrastructure requires approximately $20 million in investment over the next 10 years, approximately half of which is on the airfield and therefore eligible for federal funding. The Board approved a $3 million loan from the General Fund this fiscal year for airfield paving pending the outcome of this Plan Update and the future direction of the airports system. If the County chooses to apply for federal grants in the future, a portion of the cost of the paving project could be eligible for retroactive grant reimbursement.

- Over the long term, the AEF may be able to generate sufficient revenue to fund anticipated operating and capital costs, including the necessary infrastructure investment, if the County is able to more effectively utilize the airports' real property assets. In other words, the AEF cannot remain financially self-sustaining unless the airports' real property assets are employed to generate additional revenue. The process for leasing real property is lengthy. It will be several years or more before the parcels identified in the Business Plan could begin to produce revenue. <u>However, this assumption must be tested and verified through a solicitation process involving the real property assets and execution of leases to confirm the cash flow anticipated by the report.</u>

- If the County resumes accepting Airport Improvement Program (AIP) grants, the funding can be used to reduce the backlog of deferred airfield infrastructure improvements. It is important to note that AIP funding cannot be used to fund facility ongoing maintenance and operations, which is the challenge to the longer term financial viability of the airports system.

- Should the County continue to forego AIP grants it is likely that additional loans to the AEF would be required to fund future needed airfield projects until such time RHV's real property assets generate revenue to help pay for these capital projects. This assumes the FAA would provide property releases. However, foregoing the federal grant funds would allow the County greater flexibility with respect to future operations beginning in 2031 when the existing federal grant obligations expire. It should also be noted that the County could apply for AIP grants for San Martin Airport, but not for Reid-Hillview Airport.

The Business Plan Update describes a series of interrelated issues involving revenues, expenditures, grant funding and the general aviation market as they relate to the health of the

Airport Enterprise Fund (AEF). It also discusses the overarching issue of grant funding and grant assurances as they relate to the County's ability to exert local control over the airports.

Discussion of the Issues around Acceptance of Grants

The federal government provides grant funding for eligible airport development projects through the Airport Improvement Program (AIP). The AIP program was established by the Airport and Airway Improvement Act of 1982 to provide funding for airport planning and development. The Airport and Airway Trust Fund, which was established by the Airport and Airway Revenue Act of 1970, provides the revenues used to fund AIP eligible projects through taxes or user fees that are collected from the various segments of the aviation community. No general taxpayer funds go into the Airport and Airway Trust Fund.

A portion of current AIP grant funds are assigned to eligible airports on an annual basis. For Reid-Hillview and San Martin, the FAA provides up to $150,000 per airport per year in "entitlement" funding that can be used for any eligible project. The FAA will allow sponsors to bank their entitlement for up to three years so that in the fourth year, a sponsor will have up to $600,000 for each individual airport that can be used on an eligible project. After three years, the oldest unused funds are released to the FAA for distribution to another airport through the AIP program. The County has not received FAA AIP grants since 2011. During part of this period, the County was denied grants due to a dispute involving skydiving at San Martin Airport, and, as a result, $1.5 million in federal entitlement funding has been redirected to other local airports. Each year that the County does not apply for AIP funding for both airports, an additional $300,000 in entitlement funding will be redirected to other airports.

In addition to entitlement funding, AIP grant requests may also be considered for discretionary funding, which are made available to airports on a competitive basis subject to funding availability. Regardless of funding source, (entitlement or discretionary) the AIP program provides up to 90% of the eligible project value in federal grants funds with up to 5% of the project value available through State grant funding.

The Board of Supervisors recently approved a loan of $3 million to the Airport Enterprise Fund (AEF) from the General Fund to repave the runways and taxiways at the airports. This recently completed project was structured to be federally compliant and therefore grant eligible. Should the County resume accepting grants, staff will submit a grant application for this project.

Entitlement funds may be used to retroactively fund projects. Therefore, the County could apply the $1.2 million in entitlement money accumulated for each of the two airports towards the general fund loan, and then apply the annual $300,000 in FAA entitlement funds over the next six years to complete payment on the remaining balance of $1.8 million. After six years, the County could then accumulate future AIP entitlement grants for other needed projects. During that six-year period, however, the County could still apply for discretionary funding for grant-eligible projects.

Airports require constant maintenance. The runway and taxiway pavement, along with the parking ramp and lighting, signage, and surface markings all have a finite life and must be periodically renewed and replaced, regardless of the demand for aircraft parking. AIP grants can pay up to 90% of those costs with another 5% provided by the State. Without grant funding, the County must pay 100% of those costs.

When receiving AIP funding for projects, the grant recipients must agree to a series of thirty-nine grant assurances (assurances). These are binding agreements between the federal government and the local agency regarding the operation of the airports. The assurances include specific requirements for how the grant funding will be utilized, how the project will be executed, and a variety of requirements on how the airports will be operated. Grant assurance agreements generally last 20 years.

Grant assurances fall into two categories[1]; assurances specific to project, of which there are nineteen, and assurances that dictate specific requirements for long-term operations of an airport, of which there are twenty.

Generally speaking, the intent of the group of twenty grant assurances relating to operating the airport is to ensure the grant recipient maintains and operates the airport safely and efficiently. Most of the assurances align with the County's desire for safe and efficient airports and make good business sense.

However, a number of the assurances may restrict the ability of the County to regulate the airports in ways that may be desirable and to reduce conflict with surrounding land uses. For instance, the assurances restrict the County from imposing a time-of-day curfew, and from regulating the size and type of aircraft using the airports, or the types of uses, such as, pilot training or skydiving.

Since the County most recently accepted grants in 2011, the most recent AIP grant agreement states that the County is currently obligated to comply with the assurances until 2031. In addition to the assurances, the Airport Noise and Capacity Act of 1990 also regulates the operation of airports in the United States, including generally prohibiting the enactment of curfews.

The attachment provides a brief overview of the different grant assurances and groups them into project specific assurances and airport operation assurances.

Grant Acceptance Risks

Another issue regarding grant acceptance relates to risk the County may be exposed to should it elect to accept FAA AIP grant funding going forward. If the airports general aviation business diminishes to the point that the AEF is no longer self-sustaining, the County would be required to keep the airports operating for the duration of the grant assurance period. The AEF budget for FY 18/19 is approximately $2.7 million dollars. This is the theoretical <u>annual</u> maximum exposure to the General Fund in today's dollars should airport revenue go to zero for the remainder of the grant assurance period. Of course, if the airport business declines that severely, staff would employ cost saving measures to reduce to the greatest extent

[1] There are three grant assurances that are specific to commercial air-carrier airports and consequently do not apply to the County airports. 10. Metropolitan Planning Organization, 12. Terminal Development Prerequisites, and 39. Competitive Access

possible the General Fund exposure and operate the airports at the minimum viable safety level.

Accepting grants would also preclude the County's ability to control types of aviation uses at the airports.

Constraints Related to the Airport Noise and Capacity Act

The Airport Noise and Capacity Act of 1990 (ANCA) regulates local operators of public airports in important ways. Through ANCA, the FAA retains authority over the creation and implementation of access restrictions at all publicly owned airports, regardless of whether jurisdictions accept AIP grants. This means that any restrictions the County might wish to enact regarding the types of uses and time of use restrictions once the existing AIP grant assurances have expired would need to be reviewed and authorized by the FAA. Practically, this means that the FAA could likely prevent the County from imposing curfews, even after the grant assurances expire.

In light of the fact that the Airport Noise and Capacity Act would still require the County to operate the airports similarly to airports receiving AIP grants, staff recommends that the Board of Supervisors approve retroactive use of existing available Federal entitlement moneys to begin paying down the principal of the loan. In addition, Staff recommends that the Board of Supervisors direct the Administration to apply for reimbursement for the remainder of the principal to the maximum amount possible. Acceptance of these monies will require the acceptance of new grant assurances for a new 20-year term.

Property Releases

A key premise of the Business Plan Update is the non-aviation use of airport property. Since all Reid-Hillview property was purchased with FAA grant funding, the FAA must authorize use of the airport property for non-aviation use, a process referred to as a property release. The FAA frequently allows such development at other airports, but to date, it has been unwilling to release, for example, the Reid-Hillview parcel at the corner of Capitol and Tully shown in the attachment. Should the Board agree to move forward with non-aviation development, a property release request would be submitted for the airport parcels in question, and the County believes that the FAA would likely be legally required to approve it; however, it is unknown how the FAA will respond.

<u>Strategy for Non-Aviation use of Property</u>

Pending direction from the Board of Supervisors and concurrent with the request for property releases, staff would draft the Request for Proposals for the real property identified in the Business Plan Update. The Board will be asked to approve the RFPs and subsequent leases should the County come to terms with interested land developers. The process including any City of San Jose land development approvals would require a minimum of three years. <u>At this point, the revenue projections for the airport can be adjusted to reflect the new leases and the County would have certainty around the fiscal health of the airports.</u>

County staff has requested land releases from the FAA in the past. The most recent land release request is attached. Land releases are a critical approval necessary for the success of the business plan and the clearest path to providing funding for ongoing maintenance and operations. Board approval of this business plan is a crucial step in the land release application process.

Fixed Base Operators Strategy

The purpose of the FBO strategy as recommended in the Business Plan Update is to improve competitiveness for aircraft and pilot services, use the airports land more efficiently, and improve quality of the buildings and grounds through the development of "Minimum Standards". While this strategy is unlikely to result in significant revenue changes for the AEF as FBO lease proceeds are a small fraction of revenue for the AEF, the consolidation of FBOs would free up land that could then be available for non-aviation ground leases.

The original leases for the FBOs at RHV were executed between 1965 and 1973. It can be surmised that nine individual leases provided the best mix of aviation service providers for the airports needs at that time. The nine FBO leases at RHV have all been adjusted to expire concurrently in December 31, 2021. The concurrent expiration is a strategy staff employed to ease implementing the new full service FBO strategy as described in the Business Plan Update.

Of the nine existing FBO leaseholds at RHV, only two provide a full range of services. The remainder of the FBOs act more as what the FAA defines as a Specialized Aviation Service Operator. These operators usually provide a single service.

The Plan recognizes the change in the aviation business climate since the mid-1970s and recommends reducing the number of leaseholds from nine small operations to two larger operations. Under the two FBO scenario each of the proposed FBOs will be required to provide a full range of services. As part of the RFP, a minimum standards document will be prepared to ensure that the two FBOs provide a full range of aviation services including fueling, maintenance, parking, rentals, ground support and terminal services. This will provide appropriate market competitiveness for services and eliminate the case where only one service provider sets pricing.

In addition, by reducing the number of leases, the FBO layout can be made more efficient, by providing a more coherent land side and air side interface. As a result, the lease area can be reduced from 18 acres to approximately 14 acres. The plan proposes the excess land be made available for non-aviation use subject to FAA property release.

Below are two diagrams showing the existing lease layout and the recommended lease layout. The recommended plan provides for an orderly airside and landside interface between the leaseholds and eliminates three "cul-de-sacs" necessary to provide landside and airside frontages for the exiting nine parcels. In addition, the new Plan may eliminate the need for John Montgomery Drive on the land side and free up an additional land that may be used for future non-aviation uses.

Existing Layout of Leases at RHV

Proposed layout of leases at RHV

Any new FBO business model will be presented to the Board for approval once the RFPs are developed. Significant outreach with new potential vendors as well as existing tenants will be provided.

The FBO lease at San Martin Airport expires on December 10, 2020. The single FBO at San Martin provides services commensurate with the demand for a smaller airport.

Nonprofit Use of Airport Property

The Business Plan Update identified two properties that occupy airport property that are not paying the AEF market-based rent. This arrangement is not appropriate for an enterprise fund. Both the Eastridge Little League and the San Martin Lions Club provide valuable service to the community. Recognizing the challenge these two organizations would face in acquiring properties, the Plan recommends the County identify funding to appropriately compensate the AEF the value of the real estate asset. This plan does not recommend removing either use.

Recommendations

<u>It is recommended that the Board of Supervisors do the following:</u>

1. Approve the Business Plan Update.
2. Direct the County Executive or designee to accept $1.2 million in Federal Aviation Administration (FAA) entitlement funding to help pay down the $3 million loan the AEF received from the General Fund in fiscal year 2017. Execute the necessary Grant Agreements to receive the funding from the federal government.
3. Direct the County Executive to apply for Federal and State Grants for the Santa Clara County Airports to the maximum extent possible for the improvement of the airports infrastructure.
4. Direct the County Executive to apply for property releases from the FAA consistent with the Business Plan Update.
5. Direct the County Executive to prepare Requests for Proposals consistent with the Business Plan Update for leasing properties and consolidating the Fixed Base Operators (FBOs) at Reid Hillview Airport.

Alternatively, if the Board of Supervisors is interested in preserving the possibility to re-use the Reid-Hillview Airport property for a purpose other than an airport in 2031 when the current grant assurances expire, an option would be to do the following:

1. Approve the Business Plan Update.
2. Approve a policy statement that the County will not apply for Airport Improvement Program grants for Reid-Hillview Airport.
3. Direct the County Executive or designee to accept $1 million in FAA entitlement funding related to the airfield repaving project at San Martin Airport to help pay down the outstanding General Fund loan.
4. Direct the County Executive to apply for property releases at Reid-Hillview Airport from the FAA consistent with the Business Plan Update.
5. Renegotiate existing leaseholds to the extent possible to consolidate the FBOs at Reid-Hillview Airport to make available acreage for non-aviation development. This effort may by hindered by the failure to accept grants since the future of RHV will be viewed as uncertain by potential leaseholders.

CHILD IMPACT

The recommended action will have no/neutral impact on children and youth.

SENIOR IMPACT

The recommended action will have no/neutral impact on seniors.

SUSTAINABILITY IMPLICATIONS

The recommended action will have no/neutral sustainability implications.

BACKGROUND

Staff scheduled the Airports Business Plan Update for the HLUET Committee meeting on May 17, 2018. Due to the length of the agenda and the desire to obtain additional public input, the administration requested the item be held until the August 16, 2018, HLUET meeting.

On May 14, 2018, the Airports Commission heard the item. On May 22 and May 23 public meetings were held for the Reid-Hillview (RHV) and San Martin Airports stakeholders, respectively. In addition, County staff met with FAA in July 2018.

Airports Commission Meeting

The Airports Commission will submit its comments on the Business Plan under separate cover directly to the Board of Supervisors. However, the Commission did point out that the time periods for various fiscal analysis in the Business Plan were inconsistent. The Airport Commission also noted that in the Business Plan Update's discussion around the issue of grant acceptance, the report did not fairly balance the pros and cons of grant acceptance.

Reid-Hillview Meeting

Staff held a public meeting on May 22, 2018 between 6:30 P.M. and 8:30 P.M. in the Ocala Middle School cafeteria. Prior to the meeting, notice was posted on the County website, Facebook page, Nextdoor website and on the airports website and Facebook page. In addition, an email notice was sent to all past registered meeting attendees and all airport tenants. A flyer was distributed to all airport-based businesses and a postcard notice was mailed to approximately 6,500 properties in the vicinity of Reid-Hillview Airport.

Approximately 100 people attended the meeting. About half of the attendees were from the neighborhoods surrounding RHV and the other half were airport users and tenants. Spanish and Vietnamese interpreters were made available to assist in communication.

A slide presentation was provided to the attendees with a question and answer session following. Among the neighbors, the general consensus was that the airport is an undesirable neighbor with several comments to close the airport and redevelop it into affordable, multifamily housing and/or community-serving uses such as schools or parks. San Jose State University Aviation Department students attended and expressed the value that the airport holds for them and their efforts to obtain an aviation-based education and the opportunities that are available to the local youth as a result of the SJSU presence at the airport. Current airport tenants were concerned with the proposal to realign the FBO leaseholds with a desire to understand the mechanics of that change. There was also much discussion on the lack of clarity in the preliminary draft report regarding the benefits Airport Improvement Program (AIP) grant funding provides to the County and what benefits in terms of freedom and flexibility that would be obtained should the County elect not to accept future grant funding and allow the existing grant assurances to expire.

A summary of the meeting with comments and responses is attached.

San Martin Meeting

On May 23, 2018 between 6:30 P.M. and 8:30 P.M., a public meeting was held at the San Martin Airport to discuss the preliminary Business Plan Update. The meeting notice was posted on the County website, Facebook page, Nextdoor, and on the airports website and Facebook page. In addition, an email notice was sent to all past registered meeting attendees and all airport tenants. A postcard notice was mailed to approximately 500 properties in the vicinity of San Martin Airport.

Approximately 50 people attended this meeting and fewer than five attendees identified themselves as being from the surrounding community. The remainder were airport users and tenants.

The same slide-show presentation from Reid-Hillview was presented at the San Martin Airport. The discussion at San Martin was largely about what will happen when the FBO leasehold expires in 2020. The FBO leasehold includes hangars that will revert to County ownership upon expiration of the FBO lease. Some occupants of the FBO hangars claim ownership of the hangars. This is not consistent with the FBO lease. Additional discussion was held on the value of accepting AIP grant funds, and the existing Airport Master Plan that includes possible additional development at the airport, including a lengthened runway.

A summary of the meeting with comments and responses is attached.

Meeting with the Federal Aviation Administration

Staff met with the FAA, Airport District Office (ADO) on July 27, 2018 to present the preliminary draft Business Plan Update and discuss its intent and purpose.

County staff presented the Plan to the FAA staff in attendance. Staff explained the intent of monetizing excess land and realignment of the FBO's at Reid Hillview in the context of improving the fiscal outlook for the Santa Clara County Airports.

The FAA staff expressed continued concerns about the County's failure to apply for AIP grant funding. The FAA staff indicated that failure to apply for grants is usually a precursor to an attempt to close an airport. In addition, property release requests are also frequently seen as an effort by an airport operator to justify future closure of an airport. The FAA indicated that past property releases submitted by the County were viewed in that context.

After an in-depth discussion of the Plan's strategy, including the property releases, the FAA staff indicated that there is likely to be an opportunity to negotiate the property releases once the Business Plan Update is approved.

The FAA was receptive and appreciative of the efforts the County has made and expressed a desire to actively partner on improving the airports. To that end, staff and the ADO office will meet again in the fall of 2018 to review the outcome of the HULET and Board of Supervisors actions.

CONSEQUENCES OF NEGATIVE ACTION

The County would continue to operate the airports with the existing leasehold mix; revenue and expenditures would largely remain the same with expenses rising relative to economic conditions and increases to rents indexed to the Consumer Price Index (CPI).

The FY 2019 budget for the Airports division calls for a $268,000 transfer from Retained Earnings to the operating budget. Without additional revenue sources, this is a trend that is expected to continue indefinitely. The deficit does not include any capital investment. All capital needs will necessitate additional funding. Under this scenario, a long-term subsidy of approximately $20 million dollars over ten years is required.

STEPS FOLLOWING APPROVAL

ATTACHMENTS:

- RHV Public Meeting Summary 05/22/18 (PDF)
- San Martin Public Meeting Summary 05/23/18 (PDF)
- Written Public Comments (PDF)
- Grant Assurances (DOCX)
- FAA Release Requests (PDF)
- Airports Business Plan Update Prelim May 2018 (PDF)