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Us Airport Privatization: Why It Won't Work (1993)

- The existing real estate depression has created a vast pool of competitive real estate investment opportunities. These are less risky, more familiar and can be acquired by the private sector relatively cheaply given current market conditions. The majority of airports in the United States are not competitive attractions for investment capital.
- The best qualified segment of the private sector i.e. experienced property developers, are by temperament and tradition ill suited to assume a position which will undoubtedly require them to act in a quasi-governmental style. They will chafe under the requirement that they work closely with the FAA and are unlikely to accept the delays and frustrations that go hand-in-hand with major airport operation.
- The vast majority of airports are worth far less based on the capitalized value of their potential Net Operating Income than they are based on the depreciated value of their physical assets.
- The most desirable "blue chip" air-carrier facilities in the major cities may require potential private operators to absorb the existing infrastructure of airport management, labor and security or suffer unacceptable political backlash. Private airport operators forced to start out with essentially the same size airport workforce and payroll would be hindered in establishing cost saving labor practices.
- The divesting public entity will get little or nothing from the airport in the area of increased property taxes because anything approaching full assessment of the airport's land, runway and taxiway system and other physical improvements will destroy the airport's bottom-line capacity to generate a profit, and remove the incentive for a private operator to buy or lease a facility.
- Private operators will remain dependent upon the government's capacity to exercise eminent domain and compliance with Part 77. Additionally, expansion of the facility to accommodate airside and landside demand may create financial and public relations problems the private sector would be reluctant to assume.
- If privatization does occur it will not be at large air-carrier facilities, but at smaller financially strapped airports in both the air-carrier and general aviation category. The monetary benefits which will be realized via privatization will essentially be the release of the public operator entity from the obligation to underwrite airport debt service and operating deficits.

At the outset of this article, let me state that the arguments contained in it are not ideologically driven. The observations I have made are purely my interpretation of the economic realities of airport operation, and more importantly, the marketplace in which airports would have to compete as investments.

Privatization's biggest problem is that airports are not an economically efficient utilization of real estate. The largest have vast amounts of acreage which are dedicated to contributing support for runways, taxiways, clear zones and noise buffers. The basic problem with an airport is that when all the depreciated and undepreciated physical aspects of it are added up, the "value" far exceeds the capitalized value of its Net Operating Income. The typical investor buys income producing property based on its capacity to earn income, not "book" value or replacement cost. If an airport is ever purchased outright, the purchase price will reflect its income producing potential in an artificially formed and controlled economic environ, not the depreciated value of its assets.

Any discussion of airport privatization should also address just who or what "market" for privatized airports consist of. There is no definable pool of potential investors who will operate an airport property in the same manner that other income producing property such as office space and shopping malls are operated. It is also unlikely that the most skillful and qualified real estate developers will become involved in airport operations. These individuals and organizations are by definition lean and mean. Most have a stripped down operation which allows them to respond to the changes in the real estate marketplace. It is unlikely that the most successful real estate developers will be readily adaptable to the quasi-governmental approach which will be required in running and operating a major airport facility. Any owner of a privatized airport will still be required to interact with the FAA and to a large extent with the municipality which conveys the property to him. This will require a great deal of patience and capacity to pursue a long-term strategy.

Along with the fact that nobody really knows what a private investor will pay for an airport, or who these private investors are specifically there is a larger problem of the competitive position of potential airport investments in the overall real estate marketplace. Right now, the current real estate slowdown has created unparalleled investment opportunities for those with the cash to take banks, the FDIC and struggling developers out of their positions. Real estate operators are buying at prices which are a fraction of the property's original construction cost. They know that the market will ultimately turn around. As a result, airports will be unable to seriously compete with well-located shopping malls, office buildings and other income producing properties.

If an investor can be found and is willing to pay a price which is palatable to the municipal entity selling the facility, it is likely that the private owner will be forced to absorb much or all of the existing airport infrastructure of employees and management. It is unlikely that any municipal entity will be able to make a transfer of their airport facility palatable if it threatens to put citizens out of a job and/or come in conflict with preexisting union agreements. In effect, the private operator will have to buy the infrastructure of employees and management that may contribute to the airport's lack of profitability.

Privatization has also been touted as a way for a municipality to place airport real estate back on the tax rolls. This is the ultimate "Catch 22" of privatization theory. If airport property is assessed and taxed at anything like its true value, the airport's capacity to make a profit will simply vaporize. No amount of efficiency brought by private operation will be able to offset the burden of a full real estate tax assessment on every square inch and every brick of airport property. If you are reading this now, and you run a municipal airport, try this with your own facility's income and expense statement. If your airport makes a profit now, it won't if real estate taxes have to be paid.

In addition to these other problems, a private airport operator will lack the government's capacity to exercise the powers of eminent domain. In the case of an airport which is a major air-carrier facility and a participant in the AIP Program, the private airport operator will still have to comply with the provisions of Part 77 for compliance and safety reasons. Without powers of eminent domain, the private operator may be forced into long, expensive and politically disadvantageous acquisition exercises which draw unwanted attention to the airport and may possibly inspire high levels of community opposition. This would be particularly true in the event of a major runway expansion project or a similar program.

Having given a lot of reasons why I think airport privatization will not happen, let me say that there are some, if limited, opportunities for the private sector with regard to American public airports. The most promising targets for privatization are ironically those airports which are in a deficit position. In these instances, a municipality might welcome the opportunity to get out from underneath the annual operating deficit. Additionally, private management and operation can bring efficiencies to airport operations. In this situation, the property will be conveyed via long-term lease for annual payments which will undoubtedly not represent "market value". The value to the municipality will be the relief of an annual obligation to underwrite a deficit producing operation. In return, the private investor will get a chance to develop profit via intelligent, and market-driven exploitation of the real estate assets of the airport. This will stem from aviation related uses and with non-aviation uses.

Even these transactions will be few and far between, however, due to the fact that almost invariably the private operator may have to assume debt service and principle payments relating to previously issued airport bonds.