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Will Airport Reconfiguration Justify the $1.1 Billion Cost?

Summary: The Allegheny County Airport Authority has announced plans to reconfigure the terminal system at Pittsburgh International Airport. The estimated cost is $1.1 billion. But is this expensive project justified given the current, or even projected, demand for air travel? And will the authority be able to finance the project? This *Brief* explains the difficulties the plan faces.

In mid-September the Allegheny County Airport Authority released a proposal to reconfigure the terminals of Pittsburgh International Airport (PIT) at a cost of $1.1 billion. The plan includes a new landside terminal that will be connected to the current airside terminal, a new parking garage and new infrastructure to reconfigure the property. Needless to say local officials argue the project is necessary to update the facility.

Authority officials stress that no local taxpayer money will be used and that it will not have to increase landing or other fees charged to airlines servicing PIT. Instead, to repay the bonds issued to fund the project, the authority will rely on savings from the reconfiguration, specifically the savings from maintenance costs from the old landside terminal, revenue from airport parking, concession and retail sales, a passenger facility charge and grants (federal and state tax dollars), along with royalties from Marcellus Shale gas extraction on airport property.

A reality fact-check

The current terminal system was built over 25 years ago to the specifications of US Airways, then one of the largest airlines in the nation. It was constructed to accommodate more than 30 million passengers expected from US Airways growth at the Pittsburgh hub. Today, after bankruptcy filings and mergers, US Airways is gone, having acquired American Airlines and adopting that venerable name. PIT never saw the passenger level projections that were used to justify the much larger terminal.

In fact, the highest passenger count at PIT was only 19.9 million (2001) while it was still a major US Airways hub. News reports note that the new facility will be able to handle about 18 million passengers. Whether or not the 18 million figure is ever reached, the traffic will almost certainly be exclusively origination and destination passengers, as there appears to be little prospect of any airline putting a significant hub operation at PIT.

Since the 2001 peak passenger count, and as the fortunes of US Airways tumbled into bankruptcy and downsizing, annual passenger totals fell through the next several years dropping to 8 million passengers in 2009. From 2010 through 2016 the passenger counts ranged between 7.88 million in 2013 and 8.31 million in 2016, with an average of 8.1 million thus far this decade. The projected total for 2017 is about 8.39 million—slightly above the 2016 level, but still well below the 2007 level. The harsh reality is that PIT's slide has lowered its ranking to 48th among U.S. airports in terms of enplanements.

With PIT relying on origination and destination travelers, passenger growth will depend heavily on two factors: the gains in population and expansion of the economy, especially income and employment. Availability of very cheap flights and more non-stop destinations can induce higher demand. However, the effect is limited as shown by the recent experience at PIT.

While the area's population decline is not as dramatic as it was through 1990, it is still slipping. The seven-county Pittsburgh metro area's 2016 estimated population count was 2.342 million—down from 2.356 million in the 2010 census which was down from 2.431 million at the beginning of the millennium. There is little or no indication that the metro area is on the verge of a substantial upturn in population growth.

Further, payroll data shows the area's employment gains have been very anemic over a long period. In 2000 average monthly non-farm jobs stood at 1,159,800. By 2016 that number had managed to rise a scant one percent to 1,172,000 jobs. National growth during this period was 9.4 percent, far from strong, but the period did encompass the massive recession of 2008-2010. In Allegheny County personal income per capita expanded by a mere 2 percent per year between 2007 and 2015, not much, if any, after adjusting for inflation. Thus, the area's economy has exhibited very slow gains over a long period and surely can offer no optimism that it will suddenly start to rise rapidly driving up demand for air travel.

Much has been made about PIT's ability to attract low-cost airlines such as Frontier, Condor, WOW and Spirit. This is offered up as proof that the demand for air travel from PIT is growing. But it is worth noting that several of these carriers were lured here with subsidies in hopes of stimulating demand.

Frontier Airlines, after only one year, has already announced a reduction in the number of destinations from five cities to just two, and their flights will be seasonal and limited to just a couple of days per week. Will other low-cost carriers face the Frontier problem, especially those with subsidies when the subsidies expire? Clearly, added competition and carriers have done little to produce an appreciable rise in passengers.

How does PIT expect to pay for the $1.1 billion retrofitting?

News reports say the authority will use savings from closing the current landside terminal, estimated to be about $23 million. The most talked about savings would be realized from the elimination of the tram between the airside and landside terminals, people-movers, elevators and escalators, all of which are coming to the end of their useful lives. The thought is that instead of replacing or repairing these items, it would be more appropriate to build a new landside terminal. As one aviation consultant was quoted as saying, "You're going to spend $1.1 billion to save $23 million? What Wall Street person would ever make that decision?"

Using a standard repayment formula, $1.1 billion in 30 year bonds at 5.5 percent interest, would require annual debt service of about $75 million per year. With $23 million in expected annual savings from abandoning the current landside terminal leaves around $52 million the authority will have to find to make the full payment. At the end of 2016 PIT had long-term principal and interest obligations of $209 million through 2031. A 2017 debt service payment of $62.1 million is due followed by a payment of $57 million in 2018. After that payments fall substantially and by 2022 roughly 80 percent of the $209 million in principal and interest will be paid with the remainder to be completed by 2031. And this assumes no additional borrowing, other than for the planned reconfiguration.

Beginning in 2019, the debt service payment decline will, assuming all revenues remain in place and no unexpected expenditures arise, free up $40 million or so that could be applied to new debt. That number would rise to around $60 million in 2031.

But there are a couple of questions with the scenario implicit in the plans for financing the reconfiguration. One, how will the net operating revenue and expenses balance move over the next 30 years? The terminal concourses that are to remain in place and related other infrastructure are almost 30 years old. Maintenance of those structures or their replacement will be very expensive. Other costs will also rise over the three decades. Will revenues from operations and fees keep pace? Where are the long term costs and revenue forecasts?

Two, there can be, and are likely to be, troubles with the special non-operating revenue sources listed by the authority as their sources to cover the project cost: gaming money, gas royalties and the passenger facility charge.

When the state's gaming law was signed in 2004, it included a payout of $150 million to the authority to help with the airport debt. The money was to be paid in equal installments over 12 years starting in 2007. However, as *Policy Brief, Vol. 9, No. 62* explained, the County Executive claimed the authority owed the county $42.5 million and arranged to intercept that amount off the top, leaving $107.5 million for PIT. According to the latest authority comprehensive annual financial report (2016 CAFR), these payments to PIT began in 2010 with a $14.6 million payment.

From 2011 through 2016, the annual payments have totaled $89 million. This leaves just $18.5 million of the original $150 million gaming money to be received in the next two years. Therefore, gaming tax dollars will not be available to pay off any new debt. Not unless the Legislature and governor agree to renew the gaming money appropriation for PIT. And given the state's dire budget problems and other program funding needs, this does not seem likely, especially since the $150 million set aside for PIT was not at all popular with some legislators when that deal was made. Other parts of the state will want that money allocated to them.

Then, too, revenue forecasts from gas royalties are problematic. When the authority executed an agreement to begin unconventional gas drilling on its property, it received a $46.3 million upfront payment. The authority decided to realize that as non-operating revenue over a five-year period, ending February 2018 (roughly $9.26 million per year). Thus the bulk of that money has already been received. In 2016, the authority began receiving royalty payments from gas being extracted from the property—$3.2 million. Obviously, royalties will have to be much greater than $3.2 million to play much of a role in servicing a billion dollar debt.

With more drilling taking place and greater production possibly forthcoming, royalty payments could increase. However, with the price of natural gas suppressed as new supplies are being tapped in Pennsylvania and elsewhere, royalties might not rise as hoped. Moreover, since the likely term of the construction bonds will be 30 years, it is very probable that aging wells will have become less productive and whether new wells will find other pockets on the property to refresh the gas flow is unknown.

Another non-operating revenue stream mentioned as a funding source is the passenger facility charge (PFC). This is a charge allowed by the Federal Aviation Administration (FAA) and is currently capped at $4.50 and charged to "qualified … enplaning passengers by airports to finance eligible airport-related projects that preserve or enhance safety, capacity or security of the national transportation system; fund noise mitigation at the airport; or furnish opportunities for enhanced competition between or among air carriers."

The FAA has to approve the projects on which the PFC can be spent and this could present a problem. Obviously, reducing capacity from 30 million to 18 million passengers is not enhancing capacity. And the planned reconfiguring seems to do little to enhance national transportation security, reduce noise or furnish opportunities for enhanced competition.

According to the CAFR, the authority collected $168 million in the PFCs from 2007 to 2016—an average of $16.8 million per year—with $16.3 million collected in 2016. Among the FAA approved projects on which this money can be spent is an allowance for "reimbursement for pre-application projects (to be applied to debt service)." Thus the PFC has been helpful in lowering the old debt from terminal construction. But will the FAA approve using the PFC revenues for the reconfiguration plan? That will need to be taken care of immediately if it has not already.

Surely, the experience with the failure of the massive spending undertaken for the current terminal configuration to produce a self-funding facility would lead planners to be cautious about claims for huge new projects. Some reasonable sounding projections of the next 20 years of operations revenue and spending including maintenance and replacement costs for aging equipment and infrastructure along with forecasts of non-operating revenue and debt service loads should be an absolute must. Stakeholders and the taxpayers ought to see exactly what the project portends in terms of financial viability. It is unlikely that the commonwealth will be prepared to come with another bailout. Indeed, that should not even be contemplated given the amount of money it has provided for roads and access to the airport already.

In sum, a very close, objective, look at what passenger traffic, airport revenues and expenses are likely to be in the future is a prerequisite for proceeding with the reconfiguration plan. The region does not need another big failure to go along with the overly expensive, downsized North Shore Connector project or taxpayer funded stadiums that have yet to deliver promised economic payoffs.

Frank Gamrat, Ph.D., Sr. Research Assoc. **Jake Haulk, Ph.D., President**

Allegheny Institute for Public Policy
305 Mt. Lebanon Blvd.* Suite 208* Pittsburgh PA 15234
Phone (412) 440-0079 * Fax (412) 440-0085
E-mail: aipp@alleghenyinstitute.org