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Is PIT's terminal project affordable?

Summary: The Allegheny County Airport Authority plans to build a new landside terminal, with accompanying parking structures and service roads at Pittsburgh International Airport (PIT). Construction is expected to start in 2019 and be completed in 2023 and is expected to cost at least $1.1 billion. The authority has reassured the public that no local tax dollars will be used but will rely primarily on airline revenues as well as revenues from the state gaming tax and royalties from gas drilling at the airport. But is this funding plan reliable? Or will state taxpayers be asked to help out once again?

Estimates place the cost of the Terminal Modernization Program (TMP) at approximately $1.1 billion dollars. But authority officials have stated there is uncertainty about the exact cost. According to authority officials TMP goals are to stabilize airline costs; build Pittsburgh's new terminal; become more environmentally sustainable; enhance the experience for all customers and passengers and provide value to the greater regional community.

Noticeably absent from any of the authority's goals is a commitment to, or assurance of, financial sustainability. What will the authority, with over a billion dollars spending on new facilities, accomplish in terms of increasing the number of flights and destinations and affordability? How disruptive will the construction be to passengers and to flights getting to and out of gates?

The authority promises that no local tax dollars will be used for the project. Instead it will be funded by airline revenue, parking and terminal concessions, Gaming Act revenues (which are, in fact, tax dollars that could be used for other purposes) and Marcellus Shale royalties. A review of data in the authority's Comprehensive Annual Financial Reports (CAFR) from 2013 through 2018 provides a picture of trends in revenues and expenses over the last five years.

PIT's largest revenue source is "airline rentals and fees." These include terminal rentals, baggage facility and tenant equipment rentals that the airlines pay. The highest year of revenue from this source was 2017 when $59.8 million was collected while the lowest was $45.2 million in 2018. From 2013's $58.7 million the 2018 collections represented a

drop of 23 percent. It remains to be seen if the big drop in 2018 was an aberration or the start of a trend toward lower revenue for rentals and fees. In any case there was little net growth in this revenue from 2013 to 2017 and that should be a matter of concern.

Parking is a significant source of operating revenues, second only to airline rentals and fees. In 2018 parking revenues accounted for $36.9 million, a 30 percent increase over 2013's revenue ($28.3 million). Did this 30 percent represent a comparable increase in parking or were there significant rate hikes that contributed to the revenue increase?

A smaller revenue source is derived from landing fees paid by carriers. Highest collections in the five-year period occurred in 2013 with $16.2 million in landing fees. However, by 2018 these fees had declined by 6 percent to $15.3 million. The low mark was in 2015 ($12.4 million) with an average of $14.4 million over the period. Landing fees were lowered dramatically from $3.5041 in 2013 to $2.325 by 2018 (signatory airlines, per 1,000 pounds). They were then subsequently raised to $2.6187 for 2019.

There are other revenue categories that increased over five years including rental car revenues (up $1.5 million), terminal concessions (up $3.5 million), other airline revenue ($2.8 million higher) and other non-airline revenue ($1.7 million). Together they account for an increase of $9.5 million in revenues.

Total operating revenue at PIT rose slightly from $136.5 million in 2013 to $140.1 million in 2018—a mere 2.6 percent. It was quite volatile during this time reaching a five-year high of $148.4 million in 2014 before dropping to $134.2 million in 2015, then rebounding to $144 million in 2017 before slipping again in 2018. Keep in mind that the Consumer Price Index during this time increased by 7.8 percent, so growth in total operating revenues at PIT fell well short of keeping pace with inflation.

Non-operating revenues, specifically the Gaming Act revenue and Marcellus Shale revenues will be counted upon to fund the TMP.

The authority receives money from taxing gaming operations under the Gaming Act. Currently, the authority has $20.4 million dollars left from a legislative appropriation of $150 million dispersion of funds over a 12-year period, which it intends to apply to debt reduction. As we wrote in 2008, the then-Allegheny County chief executive took $40 million off the top leaving the authority with $110 million (*Policy Brief Vol. 8, No.68*). From 2013 to 2016 the authority received $12.4 million dollars a year. In both 2017 and 2018 it received $8 million.

The Gaming Act was amended to give the authority $12.4 million a year in perpetuity. The difficulty with the Gaming Act is that legislation can be changed and the authority could lose the funds as a revenue source. Moreover, there is no guarantee that gaming statewide will continue to produce adequate revenue to meet the $12.4 million commitment to PIT in "perpetuity."

Income from Marcellus Shale drilling on airport property is being counted on as a source of capital for the terminal project. In February 2013 the Airport Authority signed a gas-drilling lease with CNX Gas Co. The airport received a bonus payment of $46.1 million paid in installments over a five-year period ending in February of 2018. The terms of the lease provide monthly royalty payments of 18 percent of production value. Up to now the authority has received $49.9 million in total drilling bonuses and rent payments. Gas drilling began in June 2016. In 2018, gas drilling provided the authority with $19 million (of which $17.2 million was the royalty payment, up from $15.3 million in 2017 and $3.2 in 2016). Royalties can be expected to decrease at some point in the future as the wells are exhausted over time. The TMP does not project future gas drilling royalty payments.

According to Department of Environmental Protection data regarding drilling activity there were 26 wells on PIT property in 2016 that produced 4.9 million Mcf (thousand cubic feet) of natural gas. In 2017 gas output climbed to 19.9 million and moved still higher to 22 million in 2018 from those same 26 wells.

However, thus far in 2019, data through the first four months show a reduction in both the number of active wells (20) and gas production. January through April 2019 gas extraction totaled 6.1 million Mcf compared to 8.05 million Mcf from 26 wells in during the four-month period in 2018. At the pace registered in the first four months this year, 2019's production will come in at just 18.4 million Mcf—a drop from the 2018 level. By comparison, statewide production through the first four months is up by 8 percent and at this rate would reach 6.6 billion Mcf compared to 6.1 billion Mcf in 2018. If the projection for PIT production holds, royalty revenue from 2019 will decline slightly from 2018's level unless a price rise offsets the production decline.

All this suggests that given the volatility in gas prices and the inevitable diminution of production as wells are exhausted, authority officials will have trouble coming up with annual revenue estimates for the 30-year term of any long-term bonds they plan to issue. Reliance on gas royalties and Gaming Act revenues will be problematic because they are non-operating revenues with significant forecast issues.

Borrowing $1.1 billion over 30 years, the low end of the project estimate, at 5 percent interest would entail annual payments of $70.8 million. At 3 percent, payments would drop to $55.6 million. On the other hand, 7 percent would mean $87.8 million. In either case the non-operating revenues from Marcellus Shale royalties and gaming tax revenues would cover far less than half of the needed annual payments.

And, of course, PIT has operating expenses that will have to be covered in addition to the capital expense of the terminal project and any other necessary capital outlays over the bond retirement period. Operating expenses include salaries, utilities, cleaning and maintenance, professional services, other (i.e. miscellaneous services, supplies, materials, and insurance) as well as debt payments for any other loans or bonds outstanding.

Employee compensation is the largest operating expense. In 2013 compensation was listed at $37.8 million and grew by 43.4 percent to $54.2 million in 2018. The second-largest category is professional services outlays which rose from $15.2 million in 2013 to $23.4 million in 2018—a 47.3 percent increase.

Utility expenses were consistent over the five-year period, ranging from $10.9 million in 2013 to just over $11 million in 2018. Cleaning and maintenance expense climbed just 16 percent over the period while the "other expenses" also grew 16 percent from 2013 to 2017 ($8.4 million to $9.8 million) before jumping $5.9 million to $15.7 million in 2018 (60 percent). The only notable decrease in expenditures occurred with interest expense which dropped significantly from $18 million to $4.3 million, presumably as the debt payments from the original terminal project fell.

Over the five years total operating expenditures at PIT climbed from $106.2 million in 2013 to $122.6 million in 2018—a rise of 15.4 percent. If the rapid growth in the two largest expense categories, and the slow growth in total operating revenue continues, the positive gap between operating revenue and operating expenses will shrink considerably over the next decade or so, further increasing the difficulty of making bond payments on the terminal project.

The reality is that in order to fund the terminal project the airport will take on a huge amount of debt. This debt will almost certainly not be affordable with only the funds from non-operating revenues. It will likely take a large portion of operating revenues as well and the surplus over operating expense has been shrinking. Any effort to raise revenue through higher fees will be counterproductive to passenger counts and attracting new flights.

Will the state be on the hook again to provide funding help as it was before?

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