STATEMENT OF D. KIRK SHAFFER, ASSOCIATE ADMINISTRATOR FOR AIRPORTS, FEDERAL AVIATION ADMINISTRATION, BEFORE THE HOUSE TRANSPORTATION AND INFRASTRUCTURE COMMITTEE, SUBCOMMITTEE ON AVIATION, ON THE FAA'S REAUTHORIZATION PROPOSAL, THE "NEXT GENERATION AIR TRANSPORTATION SYSTEM FINANCING REFORM ACT OF 2007," ON MARCH 28, 2007.

Chairman Costello, Representative Petri, Members of the Subcommittee:

I am happy to appear before you today as part of the series of hearings that the Subcommittee is holding on the Federal Aviation Administration's proposal entitled the "Next Generation Air Transportation System Financing Reform Act of 2007" (H.R. 1356). We have the opportunity during this reauthorization cycle to lay the groundwork to enable us to meet the greatest challenge we currently face---transforming the aviation system so it can accommodate future demand safely and efficiently. Our nation's airports—large, medium and small—must be part of that transformation, providing the capacity to serve over 1 billion passengers annually by 2015. Today I would like to provide an overview of the airport financing reforms we seek in order to provide strategic investment in our national airport system. Our proposal contains a number of significant reforms to the Airport Improvement Program (AIP) and to the Passenger Facility Charge (PFC) programs.

We started looking at elements of our airport funding system almost two years ago. We examined airport capital requirements—from the largest commercial service airports to the smallest general aviation fields—and the ability of airports to pay for those capital improvements. We talked to the municipal bond markets and rating agencies; and we looked at emerging trends in airport financing.

Four major factors came into focus during that review that shaped our proposal.

- Capital Requirements are up;
- Airports have recovered financially from the decline in air travel at the start of this decade, but they need to increase their financial self-sufficiency;
- Small airports still depend on AIP support to meet their capital needs; and

- Federal funds for airports are limited, they need to be better targeted to fund priority requirements and to keep pace with the changing trends in aviation.

Capital Requirements are Up

Our last reauthorization came on the heels of the events of 2001. Airlines and airports were still reacting to the dramatic changes in the aviation industry, spiraling jet fuel prices, and the bankruptcies of major legacy carriers. Congress crafted a reauthorization package that reflected that unsettled state of the industry. Airports pulled back from major expansion projects, taking instead a "wait and see" attitude. Passenger traffic plunged and an atmosphere of cautiousness prevailed. But now, four years later, the industry has settled and recovered.

For the second year in a row, passenger demand on U.S. airlines was strong with 49 million passengers traveling. In 2005, commercial air carrier enplanements rose seven percent and were six percent higher than enplanements in 2000. With passenger levels back to pre-9/11 levels and air carriers shifting from larger aircraft to smaller regional jets, delays returned to the system. 2006 was the worst year ever for delays, and 2007 is shaping up for more of the same. Major airfield improvements together with enhanced technology are planned to help mitigate delays at those airports.

The impact of these changes has been shown in our latest *National Plan of Integrated Airport Systems* or NPIAS, a report we prepare for Congress every two years. This report details the projected capital needs of airports of all sizes throughout our aviation system. The current NPIAS report reflects the economic recovery of the airport industry. Capital needs across all sizes and categories of airports are up four percent over the prior NPIAS, published when the effects of September 11 were still being felt. In fact, the current NPIAS report may understate the true cost of needed capital investment, as sharp increases in construction costs occurring in the last half of 2006 were not fully reflected in the most recent NPIAS report.

Airports have recovered financially

We also studied the financial health of the airport industry itself. We found that airports had recovered financially from the difficulties of the early 2000s. Across all sizes of airports, net operating results (revenue minus expenses) are up. That does not mean that all categories of airports are profitable however. There is a direct relationship between the size of the airport (measured by passenger enplanements) and the profitability of the airport. The large airports (meaning the large- and medium-hub airports, or about the top 70 or so airports) which enplane 89 percent of the nation's passengers are profitable. These airports are financially stable and have had the ability to reach beyond federal grant funding for needed capital improvements. They have ready access to the general airport revenue bond (GARB) markets, and all but four collect a PFC.

The financial performance of small primary airports (small hub and nonhub primary airports) which enplane 11 percent of the nation's passengers, has returned to the levels of the late 1990s, but those levels are not always robust. Many of these airports just break even and even more operate at a loss. Most collect a PFC, but we found that these airports continue to rely on federal AIP grants for major capital improvements. The general aviation (GA) community also reflects the stratification found in the commercial service airports. The largest of the general aviation airports are more financially stable, but the GA airport community, as a whole, depends on AIP for funding capital improvements.

Airports need to increase their financial self-sufficiency

There was also a consensus that airports need to reduce their reliance on air carriers when making major capital improvements. The financial markets were unified in their positions that airports relying on the inherent revenue-generating potential of their local market-their passengers-rather than the vagaries of airline financial health, make the strongest credit risks. Financial markets see local revenue, especially that generated through PFCs, as stable and desired sources of airport revenue. The financial markets also recommended that airports increase non-aeronautical sources of revenue, such as from concessions providing services to airport users.

More strategic Federal investment—AIP and PFC Reform

AIP Reform

Our proposals for Airport Improvement Program and Passenger Facility Charge reform are designed to empower local airports with strong local revenue sources and strategically target federal dollars to the airports where they will have the most impact. We are proposing major reforms to AIP apportionment and set aside formulas and are also proposing substantial reform to the PFC program.

FAA is committed to a healthy national air transportation system. Airports are a key part of the system, and that includes small primary and general aviation airports that rely on AIP funding to help meet their capital needs and complete strategic projects. Our proposal will stabilize and enhance these funding sources for airports. The level of our AIP request, when combined with programmatic changes to AIP and the PFC program, will provide the financial resources FAA needs to meet the nation's highest priorities for safety, security, and capacity. This includes projects such as upgrading runway safety areas and mitigating runway incursions, funding current and future letters of intent for capacity projects at commercial airports, preserving existing airfield infrastructure, and advancing compliance with airport standards.

Our reform proposal for AIP includes the following major elements:

- Phasing out passenger entitlements for medium and large hub airports (approximately 70 airports) after FY 2009, while preserving discretionary funding for these airports. This proposal recognizes on the one hand, the ability of these airports to finance their own routine capital needs through the PFC program. On the other hand, the important role these airports play in the national system is recognized by continuing to allow these airports to apply for discretionary AIP grants for the most important projects. This change will provide more discretionary funding for the FAA to direct in order to meet national priorities.

For FY 2008 and 2009, passenger entitlements for these airports would be reduced by 50 percent from current levels.

- Retaining the higher passenger entitlements for the remaining smaller airports for all levels of AIP funding, eliminating the link, or "trigger," between these entitlement levels and an AIP funding level of $3.2 billion. This change recognizes smaller airports' continued dependency on AIP.
- Increasing the minimum discretionary fund level from $148 million to $520 million, enabling FAA to better target AIP investment to meet national priorities.
- Reforming general aviation airport entitlements to better target AIP to those airports that will be impacted by emerging technologies by –
  - Establishing a separate state apportionment fund with a minimum funding level of $300 million;
  - Eliminating the uniform $150,000 individual nonprimary airport entitlement with a tiered system of entitlements. The largest and busiest airports would receive $400,000, while the very smallest airports would receive no annual guaranteed AIP amount. These airports would remain eligible for state apportionment and for discretionary funds.
- Eliminating the Military Airport Program and Reliever airport set aside and instead funding these needs out of regular AIP discretionary funds.

In a strategic investment context, large airports are strong and mature financial enterprises that no longer need guaranteed passenger entitlements to meet their capital needs. Most of these airports are already returning 50 or 75 percent of their passenger entitlements under the PFC turnback requirements in current law. Moreover, under our proposed PFC increase (discussed below), these airports, as a group, could gain over $3 in PFC revenue for every dollar of AIP passenger entitlement lost. In FY2006, large airports were allocated approximately $295 million in passenger entitlements. Using the same passenger counts as FY2006, large airports could see an increase in PFC revenue of approximately $1 billion.

Large airports will continue to qualify for discretionary funds, including letters of intent or LOIs. Discretionary funding is a more useful form of Federal assistance to large airports, because it allows AIP to be concentrated on very costly projects that occur infrequently.

We also propose to update the AIP formula for the discretionary fund. Current law sets that minimum at $148 million (a figure dating from the 1990s, when the level of AIP was about $1.4 billion), plus a calculated amount based on Letters of Intent prior to January 1, 1996. However, all those LOIs have been completed. Our proposal would set a minimum level of $520 million, which will assure that funding is available to cover current and anticipated LOI commitments and high priority safety, capacity, environmental, and security projects, such as runway safety area projects and new runways at Operational Evolutionary Partnership (OEP) airports. We believe that airports of all sizes will benefit from this change.

Our proposal contains a broad range of formula changes for small primary airports, which depend on AIP to meet their capital needs. Current levels of small primary airport entitlements will be retained at all levels of AIP. The current statutory penalty that reduces passenger entitlements by 50 percent and reduces the minimum passenger entitlement from $1,000,000 to $650,000 when AIP levels are less than $3.2 billion will be eliminated. This proposal thus allows small primary airports to be assured of a stable flow of passenger entitlements.

Small airports of all categories will benefit from a new discretionary small airport fund that would replace the existing Small Airport Fund. The current Small Airport Fund is financed from the passenger entitlements that large airports collecting a PFC must return to the FAA. Once passenger entitlements at large airports expire in FY 2010, the current Small Airport Fund will no longer have a source of funding, so our proposal would repeal the fund as it is currently constituted. The new discretionary small airport fund would be established at 20 percent of available discretionary funds.

As noted above, our proposal also provides a more rational structure for general aviation (GA) airport apportionments while preserving their access to essential AIP funds through three critical reforms. We propose to restore the state apportionment to a meaningful level by separating it from the non-primary entitlements. We would set the level of the state apportionment at 10 percent of AIP, and provide for a minimum level of $300 million per fiscal year. This more robust state apportionment funding will allow states to meet their own strategic investment objectives, with the knowledge that this fund will be stable. This commitment to local funding through state apportionment will allow prudent growth of the individual state aviation systems.

Also in order to better target AIP funding to where it is most needed, we propose to modify the current non-primary entitlement program by providing for tiered funding levels based on airport size and aviation activity. Under current AIP formulas, while primary airports are divided into five categories, the 3,000+ nonprimary, or general aviation airports are allocated a single maximum entitlement regardless of size or role in the system. We analyzed the infrastructure needs of general aviation airports in detail in developing our proposal. The outcome should surprise no one. Busier GA airports – and those used by more sophisticated aircraft – have more complex and costly airfield infrastructure to maintain and improve. One size does not fit all when it comes to GA airports–just as one size does not fit all with primary airports. Our investment in the general aviation system must follow the model long established by primary airports. The entitlement would range from $400,000 per fiscal year for the largest GA airports to $100,000 for those airports with 10 to 49 based aircraft. Airports with less than 10 based aircraft would not be eligible for a guaranteed annual apportionment. These airports would continue to qualify for state apportionment and discretionary funds, and would retain the 95% federal share scheduled to sunset at the end of FY 2007.

The tiered general aviation entitlement is supported by historical data. This data shows that busier general aviation airports tend to be larger, have more complex airfield geometry and more sophisticated lighting and navigational aids. All of this translates into greater capital requirements. The proposed level of the non-primary entitlement is based on engineering and planning reviews that identified essential airfield infrastructure requirements for each tier of airports. We also looked at a number of measures of activity at GA airports. None was perfect, but based aircraft data had the benefits of being objective, obtainable and verifiable. Other options, such as operations or fuel sales lacked one or more of these characteristics. Based aircraft is a good indicator of the current operational status of an airport. However, like passenger entitlements, it may not be representative of all of the activity at a GA airport. There are airports that have high transient operations and low based aircraft counts. Our experience is that the capital needs of airports with high transient operations tend toward the kinds of high priority airfield projects that compete well for state apportionment or discretionary funds.

In making this tiered proposal, the FAA is not suggesting that the lowest tier airports do not need AIP funding. Rather, we have concluded that these airports do not need, and in some cases cannot use, a guaranteed annual entitlement. In the 42 states that do not participate in the state block grant program, 618 airports would qualify for the lowest tier. (We focused on the non-block grant states because we cannot readily track individual airport grant activity in the block grant states.) Of these, 134 airports, or 22 percent, did not qualify for a non-primary entitlement (NPE) in FY 2006 because they had not reported capital development needs in the NPIAS. Of the remaining airports in the lowest tier that did get a non-primary entitlement, 141 did not take a grant in the four years ending in FY 2006. In other words, 44 percent of the airports that would not receive a NPE under our proposal have shown that they do not need, and cannot use, an annual guaranteed amount of AIP. Given this data, we concluded that an annual guarantee to each and every airport in the NPIAS is not justified.

Our proposal also supports the scheduled sunset at the end of FY2007 of temporary subsidies included in *Vision 100*. Congress responded to the financial turmoil the airport industry faced in the early 2000s by including *temporary, short-term* subsidies to airports. The decision to make these subsidies temporary was the right one. The financial data shows that airports have recovered to their pre 9/11 financial conditions. The financial crisis that triggered the subsidies has passed, and the financial subsidies should be allowed to sunset. The two *Vision 100* subsidies, the Virtual Primary subsidy and the temporary increase in federal share for all but the largest primary airports cost over $150 million per year. At a time when capital development needs are rising, these funds should be better support additional capital projects at small airports.

Passenger Facility Charge Reform

The PFC program, which Congress enacted in 1990 and currently authorizes airports to collect fees of up to $4.50 per enplaned passenger, has been very successful at providing a stable source of revenue to fund capital development projects. The reforms we propose are designed to enhance the status of PFCs as a revenue source to support airport debt financing. First, we propose to increase the maximum PFC to $6.00*. Much of this proposed increase would simply compensate for inflation since the PFC was first authorized. The remainder would help airports cope with the increased capital needs identified in the current NPIAS. Also, this increase would bring in an additional $1.5 billion annually in PFC revenues to airports of all sizes. Large airports would account for about $1 billion of this increase, while small airports would get about $500 million–more than compensating for the loss of passenger entitlements (described above).

Our proposal would also expand PFC eligibility to include most airport capital development projects in non-exclusive use areas, including revenue-producing facilities, as long as it will not hinder competition, and amends statutory PFC provisions to make it easier to use PFCs to help finance intermodal airport ground access projects.

Except for the requirements for competition, PFC eligibility for capital projects would match the eligibility for using airport revenue to fund capital projects. PFCs are local airport revenue, and the airport community has demonstrated that they can be trusted to use PFCs responsibly. In talking to our stakeholders, especially small airports, one of their biggest frustrations is the inability to use PFCs to pay for the construction of revenue-producing facilities. They told us that if PFCs could help pay for the construction costs of these facilities, the airports would have more net revenue going to the bottom line, which they can share directly with the carriers in the form of reduced landing fees and terminal rents, or indirectly with the carriers by reinvesting in additional revenue-producing facilities. Either way, small airports in particular have told us that

* There is one exception to the $6 cap. To support a new pilot program for the transfer of navigational equipment, an airport selected to participate in the program could adopt a PFC of $7 (see section. 318 of our bill, discussed below).

additional PFC flexibility will help them structure their airport finances to retain current air service and attract new service.

Even connecting passengers will benefit from the use of PFCs for revenue producing facilities. Airports function as a financially integrated whole. When profits from revenue-producing facilities increase, those added profits are available to help defray the operating cost of the entire airport. Those lowered costs in turn are passed on to the carriers and ultimately the passenger. Similarly, for those airports that issue debt, higher profits from concessions may translate into better credit ratings, which in turn mean lower costs. This change in eligibility will also address one of the municipal bond market's major criticisms of PFCs as support for debt. The current criteria require expensive accounting and tracking procedures to keep PFC revenues separate from other revenue when an airport issues GARBS to finance a combination of PFC eligible and ineligible work.

The expanded eligibility should not lead to a lessening of PFC support for vital airfield and terminal capacity projects. We looked at 15 OEP runway projects completed since 1999 or under construction. Eleven of the 15 included GARB proceeds in the financing package with percentages as high as 65 percent. In other words, even when they have the freedom to use local revenue on any capital development at an airport, major airports have exercised that freedom to apply their revenue to major capacity projects.

In addition, the PFC administrative review process would be streamlined. Instead of filing applications and amendments, airports would file an annual status report reviewing how they used PFCs in the previous year and how they plan on using PFCs in the coming year. If their plan includes using PFCs for a new project, the airport would have to consult with their air carriers and provide for notice and comment in the community, just as they do today. Likewise, air carriers and the public would have an opportunity to object to a project before the FAA and to receive a determination by the FAA on project eligibility. This new administrative procedure will focus FAA's oversight on the handful of PFC projects that raise serious questions or controversy; and preserve the role of the carriers and the local community in the PFC decision process, while eliminating unnecessary federal oversight and bureaucratic paperwork exercises that provide minimal benefit to the traveling public. Airports will be able to put their PFCs to work faster building the airport infrastructure the nation needs.

Along with the increased flexibility and streamlining of the review processes for new PFC projects, this provision would also provide explicit authority for the FAA to investigate complaints of non-compliance with PFC requirements. This approach more closely resembles the same approach that current law provides for oversight of the use of other locally-generated airport revenue, including rates and charges.

For new intermodal rail projects, the current prior approval requirement will be retained. These projects tend to be controversial and require close coordination between FAA and other Department of Transportation modal administrations to determine the project's feasibility and likely airport ridership. Retaining the prior approval requirement will assure that the necessary coordination and review occurs.

Finally, this provision would extend the sunset date of the current non-hub airport PFC pilot program until adoption of final regulations for the new streamlined review procedures called for by this proposal. Once the new administrative review procedures are implemented, the pilot program will no longer be needed.

Other Program Highlights

Our proposal includes two pilot programs to encourage airports to be active participants in the NextGen transformation. One proposes a new pilot program to broaden AIP eligibility to include installing ADS-B ground stations in markets that FAA cannot reach from the ATO capital program. This program will supplement the FAA program, allowing states or metropolitan planning organizations to install ADS-B ground stations to "fill in" blank areas of ADS-B coverage, or to accelerate ADS-B coverage ahead of the FAA schedule. FAA has made a technical determination that 100% coverage with ADS-B is not necessary to assure the safety and efficiency of the system. Likewise, FAA's planned deployment schedule addresses the needs of the national system. However there may be some small airports that fall outside the planned national ADS-B coverage areas that will gain regional or local benefits from the added reliability that ADS-B coverage provides. The pilot program would be open to states, metropolitan planning agencies and regional consortiums to encourage installation of ground stations that would provide coverage at multiple airports. This coverage could extend the situational awareness offered by ADS-B to include several small airports with only one station.

To enhance transition to NextGen, the second pilot offers 10 large airports the opportunity to charge an extra dollar of PFCs (to $7.00 total) in exchange for taking over ground based terminal navigational and weather equipment at their airport. Because the FAA will not simply turn on the NextGen system and turn off the ground based legacy systems on a single day, ground based systems will need to be maintained and operated while the NextGen system is being deployed. FAA views these terminal navigation aids and weather reporting systems as functional extensions of the runways and runway lighting systems that airports already own and maintain. In many countries around the world, airports already own and maintain their navigational aids. The pilot program is limited to large airports, because we know these airports have the financial resources to operate and maintain the equipment to FAA standards.

Finally, I would note that our proposal includes a number of provisions to help FAA and airports work cooperatively to be better environmental stewards. Our bill would modify the eligibility standards and funding calculation for what now is commonly referred to as the "noise set-aside." We would extend eligibility to include water quality mitigation projects that are approved as part of an environmental record of decision (ROD) for an airport project and for carrying out projects authorized as part of a new environmental research pilot program included in Title VI of the bill. In addition to projects allowed under current law (noise mitigation, compatible land use planning, compliance with Americans with Disability Act requirements, air quality improvements such as low-emission fuel systems, gate electrification, and vehicle conversion), this section's changes would make these AIP funds more flexible so as to be available for a range broader environmental uses. To recognize this broader eligibility, we would redesignate it as the "environmental set-aside." We also propose to change how the set-aside is apportioned from the current 35% of the AIP discretionary fund to 8% of all AIP apportioned funds. This change results in a more stable funding stream for the environmental program because each year the amount of the discretionary fund varies depending not only on the overall funding level but also due to the amount of "carryover" of unused entitlements.

As noted, our bill modifies the Airport Cooperative Research Program (ACRP) and includes specific funding for environmental research. This proposal would provide for the ACRP to enhance R&D support specifically related to airport environmental needs. Funding for the ACRP would be authorized to increase from $10 million to $15 million per year, of which at least $5 million is specifically targeted to research related to the airport environment.

Finally, I would note that we propose a new pilot program to allow the FAA to fund six projects at public-use airports that would take promising environmental research concepts that have been proven in the laboratory into the actual airport environment for demonstration. Eligible projects would demonstrate whether implementation of research results would measurably reduce or mitigate aviation impacts on noise, air quality or water quality in the airport environment. For example, a project could demonstrate new operating procedures that are currently in the developmental stage that offer promising near term environmental improvements. FAA would publish information on best practices based on the results of the projects. Funding would come from the environmental set-aside of the AIP discretionary fund. FAA would fund 50 per cent of the project costs except that a maximum Federal contribution of $2.5 million per project would apply.

Mr. Chairman, our authorization proposal provides the targeted investment, program flexibility and innovations, and environmental protection that will support a healthy airport community, enabling them—large or small--to meet their capital needs and plan for future growth. It provides Federal resources to where they are most needed. I thank you for the opportunity to be here today and look forward to working with this Subcommittee as well as the airport community over the next few months as reauthorization of our programs proceeds. This concludes my prepared statement. I will be happy to answer your questions at this time.