COUNCIL AGENDA: 06-26-07
ITEM: 2.49

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Lee Price, MMC
City Clerk

SUBJECT: **LEGISLATIVE ISSUE – FEDERAL AVIATION ADMINISTRATION REAUTHORIZATION BILL**

DATE: June 22, 2007

RECOMMENDATION

As recommended by the Rules and Open Government Committee on June 13, 2007 adopt support position on the Federal Aviation Administration (FAA) Reauthorization Bill as outlined in the attached memos previously submitted to and approved by the Rules & Open Government Committee.

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: Rules and Open Government Committee

FROM: William F. Sherry, A.A.E.

SUBJECT: SEE BELOW

DATE: June 4, 2007

Approved

Date 6/7/07

SUBJECT: LEGISLATIVE ISSUE – FEDERAL AVIATION ADMINISTRATION REAUTHORIZATION BILL

RECOMMENDATION

Council is requested to adopt support positions on the following staff recommendations on the Federal Aviation Administration (FAA) Reauthorization Bill:

1. Raise the Passenger Facility Charge (PFC) ceiling from the current $4.50 per enplaned passenger to $7.50 per enplaned passenger.

2. Streamline the PFC review process and expand the eligibility criteria.

3. Increase funding for the Airport Improvement Program.

4. Establish and maintain a predictable and stable revenue streams for FAA operating and capital programs.

5. Treat airport bonds as tax-exempt public purpose bonds.

OUTCOME

Should Council adopt these positions, they will be conveyed to the City's Congressional delegation for consideration in the federal legislative process. If the federal government passes legislation containing all of the recommended positions, staff believes Mineta San José International Airport (SJC) will have new and/or more effective tools that will enhance its ability to determine its needs and fund the implementation of the solutions to address those needs, which will result in a better airport facility for the traveling public.

EXECUTIVE SUMMARY

As part of the federal budgeting process, 2007 is the year the Federal Aviation Administration is scheduled for a reauthorization review. An authorizing law provides the spending authority under which a federal program or agency operates. An authorization law usually limits the operation of a program or an agency to some specific period of time and has recommended annual funding

levels, at least for the first year of funding. The last FAA reauthorization – known as Vision 100 – was enacted into law in December 2003.
There are many sources of input into the reauthorization process (individuals, associations, agencies, etc.). The sitting Administration normally starts the process by recommending legislation in its budget. While an Administration's budget recommendation carries a degree of weight, its budget recommendation is only a recommendation. Ultimately Congress, as a whole, votes on a reauthorization bill to send to the President for signature.

The FAA has a budget of about $14.3 billion. About 19% comes from the General Fund of the U.S. Government while the remaining 81% of this year's budget comes from the Airport and Airways Trust Fund ("Trust Fund"). The Trust Fund is supported by a variety of taxes and user fees. The revenues from these sources support four major FAA programs: 1) Operations (56%); 2) Facilities and Equipment (18%); 3) Research, Engineering and Development (1%); and 4) the Airport Improvement Program (25%)

This year, the Federal Aviation Administration and its programs are up for reauthorization. In February 2007 the Bush Administration released its proposed reauthorization legislation for the Federal Aviation Administration (FAA) as part of its FY 07-08 proposed federal budget. Known as the "Next Generation Air Transportation System Financing Reform Act of 2007" – or NextGen – the Administration's proposed legislation focuses on building the next generation of the national air traffic control system as well as recommending significant changes in how airport capital infrastructure and FAA services are financed. Some of the Administration's proposals could have a significant impact on what Airport capital projects are eligible for funding, how Airport projects are financed and who pays what in taxes, fees and charges to finance the eligible projects.

A primary Administration proposal would raise the Passenger Facility Charge (a local revenue source for airports) from the current $4.50 to $6.00, which would add over $1 billion in additional local revenue to the nation's airports. In FY 05-06 San José generated $22.2 million in Passenger Facility Charges. For San José, an increase to $6 could mean an additional $8 million a year in Passenger Facility Charge revenues. The Administration also proposes giving airports greater flexibility in using PFCs and streamlining the FAA approval process for the use of PFC funding.

The Administration also proposes a reduction and redistribution of funding for the Airport Improvement Program (AIP), a capital grant-in-aid program that funds significant airside projects like runway reconstruction, safety improvements, etc. In exchange for raising the Passenger Facility Charge ceiling rate, the Administration would eliminate "entitlement" AIP funding for large and medium hub airports, like SJC, reduce overall AIP funding and focus more of that funding on capital projects for smaller airports. Though the total amount of AIP funding would be reduced by $1 billion, the amount of discretionary AIP funding would increase. Nevertheless, large and medium hub airports could be expected to use a portion of their increased PFC funding to fund some of the airside capital projects now funded by the AIP. In FY 05-06, San José received $2.3 million in entitlement funds and $18 million in "discretionary" funds. That funding was used to acoustically treat homes, upgrade noise monitoring equipment, complete major work on the Airport taxiway and install or replace airfield signs.

Some of the most controversial components of the Administration's proposals include how FAA services and funding for capital projects are to be financed. The Administration proposes shifting from heavy reliance on ticket taxes to greater reliance on new user's fees and significant increases in fuel taxes on commercial and general aviation. The FAA believes this shift will reallocate costs so that each class of aircraft customer contributes more in accord with their degree of use of FAA services. General aviation would see the greatest increase with fuel taxes raising from the current 19.3 cents a gallon to 70 cents a gallon. Part of the new user fees and fuel taxes would fund the AIP capital grant program with the bulk of the new revenue going to finance the national air traffic control system services.

In addition, airport advocacy groups, such as Airports Council International-North America and the American Association of Airport Executives, advocate that bonds issued by airports be classified as tax-exempt bonds instead of "qualified private activity" bonds. Such a change would exempt the estimated 60% of airport bonds that are now subject to the Alternative Minimum Tax and higher interest rates because they are categorized as "private activity" bonds. If this proposal were adopted, San José could save up to $40.2 million in finance charges on $606 million in bonds to be issued in a few months.

There are a number of other provisions related to the rebuilding of the national air traffic control system, the funding issues of rural and small airports and other aviations items. However, the focus of staff's analysis and recommendations are on those provisions that most directly impact SJC.

The FAA's position is that the proposals in its reauthorization bill are needed for several reasons, including:

1. The number of passengers traveling is rising and a new national air traffic control system will be needed to address the increase in use;

2. tax revenues are not growing;

3. there is little or no relation between workload, service costs and the revenues generated to pay for them; and

4. the FAA wants greater flexibility to address strategic initiatives and national infrastructure needs at critical airports.

Congress has expressed concerns with some of the Administration's proposals. In relation to the issues that are most important to San José, in general, Congress has focused the greatest level of its concern on the reduction in AIP funding and the proposed imposition of new users' fees and increase in fuel taxes. Recently, the Senate Commerce, Science and Transportation Committee has introduced its own reauthorization legislation. The biggest difference in the Senate's bill is there is no general provision for raising the PFC ceiling. There is a provision that would allow up to six airports nationwide to raise the PFC ceiling, without limit. However, it would require the airport to collect the increased PFC directly from the passengers, as, for example, from a kiosk or the Internet, without any air carrier involvement. In addition, the Senate bill contains no fuel tax increases for commercial or general aviation but would replace the current fuel tax on commercial aviation with a $25 per departure fee.

The airlines are concerned about the proposed increase in the PFC ceiling, believing it will increase the cost of doing business. The general aviation community is opposed to the significant increases in fuel taxes, believing them to be not merited. Airports and airport advocacy groups want the PFC ceiling level raised not to $6.00 but to $7.50, which they believe would fully cover the decline in buying power over the last six years of the current $4.50 PFC, due to the impact of inflation and the significant increase in the cost of construction.

With regards to the FAA reauthorization bill, City staff believes the City should have one overriding goal: To enhance the Airport's ability to determine and meet the needs of the traveling public. Towards that end, City staff recommends the Council adopt "support" positions on the following staff recommendations:

Raise the Passenger Facility Charge ceiling from the current $4.50 per passenger to $7.50 per enplaned passenger.

1. Streamline the Passenger Facility Charge review process and expand the eligibility criteria.

2. Increase funding for the Airport Improvement Program.

3. Establish and maintain a predictable and stable revenue streams for FAA operating and capital programs.

4. Treat airport bonds as tax-exempt public purpose bonds.

Staff believes these recommendations will give SJC new or enhanced tools to determine its needs and then fund the implementation of the solutions to address those needs.
Any recommendations adopted by the City Council will be conveyed to the City's Congressional delegation for consideration in the federal legislative process.

BACKGROUND

As part of the federal budgeting process, 2007 is the year the Federal Aviation Administration is scheduled for a reauthorization review. An authorizing law provides the authority under which a federal program or agency operates.

An authorization law is time-limited to force Congress to review the program or agency after a reasonable period to see if they should be continued. Funding levels are established in the authorization to guide the appropriating members of Congress on how much the program or agency should receive annually. Under most circumstances, there cannot be an appropriation for a program or an agency without an authorizing law, which is why many, if not all, federal agencies are subject to reauthorization.

There are many individuals, organizations, associations, and agencies that have input into the reauthorization process. The sitting Administration starts the process by recommending legislation in its budget. While an Administration's recommendation carries certain degree of weight, its budget recommendation is only a recommendation. Congressional committees in both the House and the Senate, and eventually Congress as a whole, votes on a reauthorization bill to send to the President for signature.

The FAA currently has a budget of about $14.3 billion. Of that amount, about 19% comes from the General Fund of the U.S. Government. The remaining 81% of this year's budget comes from the Airport and Airways Trust Fund ("Trust Fund"). The Trust Fund is supported by a variety of taxes and user fees including:

- passenger ticket taxes;
- passenger flight segment taxes;
- international arrival and departure taxes;
- frequent flyer taxes;
- cargo waybill taxes;
- commercial aviation jet fuel taxes;
- non-commercial jet fuel taxes; and
- the non-commercial gasoline taxes.

The revenues from these sources support four major programs:

1. Operations (56%)
2. Facilities and Equipment (18%)
3. Research, Engineering and Development (1%)
4. Airport Improvement Program (25%)

This year, the Federal Aviation Administration is up for reauthorization. On February 14, 2007, the Bush Administration released its reauthorization proposal for the FAA as part of its FY 07-08 proposed federal budget. The last FAA reauthorization – known as Vision 100 – was enacted into law in December 2003. It was designed to strengthen the nation's aviation sector, provide needed authority to the FAA, and enhance the safety of the traveling public.

As a courtesy to the Bush Administration, on March 6, 2007, the Administration's reauthorization proposal was introduced by the leadership of the House Transportation and Infrastructure Committee.

Known as the Next Generation Air Transportation System Financing Reform Act of 2007 – or NextGen – the proposal recommends significant changes in the how airport capital infrastructure and FAA services are financed. The recommended proposals could have significant fiscal impacts on the how capital projects are funded at Mineta San José International Airport (SJC). It is therefore important to identify primary City concerns, legislative objectives, and recommendations to achieve those objectives and then to share those adopted recommendations with the City's Congressional delegation.

The objective of this report is *not* to analyze and make recommendations on each section of the bill but to focus on those proposals that could have the greatest and most direct impacts on the City airport operations and capital projects by providing:

- An overview of the major components of the Administration's bill that will have the most impact the Airport;

- Why the Administration is proposing the revisions contained in its bill;

- Staff's recommended policy objectives in formulating recommendations on the bill; and
- Staff's specific recommended positions on those proposals in the bill that most impact the Airport.

After the City Council has approved legislative positions on the key issues impacting the City, those positions will be subsequently conveyed to the City's Congressional delegation for consideration in the federal legislative process.

ANALYSIS

Overview of Key NextGen Proposals

NextGen proposes a hybrid system of user fees, fuel taxes, international arrival and departure fees, and a general fund contribution beginning in federal fiscal year 2009 to fund the national air traffic control system, FAA safety and operations, the Essential Air Service Program (for small airports) and the Airport Improvement Program (AIP). Specifically, the NextGen proposals of greatest concern/interest to San José are in the following broad areas:

I. Passenger Facility Charges

A. *Raise the Passenger Facility Charge rate ceiling.*

Passenger Facility Charges (PFCs) are a local user fee ranging from $1 to $4.50 that is added to the price of an airline ticket to help to fund local enhancements at many airports. The PFC rate charged at a given airport is determined by each airport.

The Administration would raise the ceiling on PFCs from the current $4.50 to $6.00 and up to $7.00 for up to ten medium and large hub airports that participate in a new pilot program to take operating and maintenance responsibility for terminal area navigational aids.

B. *Allow greater flexibility on the use of PFCs to fund any project that is now permitted with airport revenue as long as it is not anti-competitive.*

The Reauthorization Bill would expand PFC eligibility to include "any capital cost that an airport could pay for with airport revenue and remove almost all approval criteria in the current statue." Of particular interest to San José, the Administration's proposal would allow use of airport revenue and PFC revenue to fund intermodal access projects even if the property is not owned or operated by the airport sponsor, provided that the project is directly and substantially related to the transportation of passengers or property.

C. *Streamline the lengthy PFC review process and approval process.*

The administration proposes to simplify and streamline the process for authorizing airports to fund identified projects with PFCs.

II. Airport Improvement Program

The Airport Improvement Program (AIP) provides grant funding from the FAA for improvements related to enhancing airport safety, capacity, security and environmental protection. To be eligible for AIP funding, the airport must be included in the National Plan of Integrated Airport Systems (NPIAS). NPIAS identifies public-use airports that are important to the national transportation system and contribute to the needs of civil aviation, national defense and the postal service. SJC is included in the NPIAS

AIP consists of two major funding pools: entitlement and discretionary. Entitlement funding is based on a formula using several factors including passenger enplanement, cargo weight shipped from the airport, etc. Airports in the NPIAS receive "entitlement" funding based on the application of the formula to their facility. Discretionary funding allows greater funding for larger projects (generally at larger airports) deemed important to the national transportation system. For the AIP the Administration proposes the following significant revisions:

A. *Reduce the overall funding level for AIP.*

The Administration's proposal would authorize only $2.75 billion for AIP in FY08 – about $1 billion less than currently authorized for the program in this current fiscal year under Vision 100 ($3.75 billion).

B. *Eliminate AIP "entitlement" funding to large and medium hub airports.*

The Administration proposes to reduce entitlement funding for large and medium hub airports (like San José) from 75% to 50% in FY2008 and FY 2009 and then eliminate it completely in FY 2010. The Administration believes the cuts in entitlements would be "offset more than four-fold by the increase in the PFC cap..."

C. *Increase the amount of "discretionary" AIP funding.*

The Administration would increase the amount of "discretionary" funding from the current $148 million to $520 million.

D. Reduce Federal share for certain projects at large and medium hub airports.

The Administration would lower the Federal share for airfield projects (runways, taxiways, aprons) at large and medium hub airports from 75% to 50%, while retaining the 75% share for all other projects.

III. Airport Bonds

A. *Classify airport bonds as tax-exempt.*

While airports are generally operated by state, regional or local governments, many airport bonds are classified as "qualified private activity" bonds because private parties, such as commercial service airlines, are significant users of airport facilities. In addition, directly or indirectly, the airlines provide a significant share of the revenues used to repay the bonds. However, projects built with these bonds, while used by private entities, increase capacity and reduce congestion in the national airspace system that facilitates trade and transportation of goods and people, benefiting even those who do not directly utilize the air transportation system. That is why airport trade associations, such as Airports Council International-North America and the American Association of Airport Executives, advocate that bonds issued by airports be classified as tax-exempt bonds. Such a change would exempt the estimated 60% of airport bonds that are now subject to the Alternative Minimum Tax and higher interest rates because they are categorized as "private activity" bonds. However, there is no such provision in the Administration's bill.

Why Change is Needed?

The Administration outlined several reasons why its proposal needs to be implemented now:

Passenger service demand is rising: Nationwide, passenger demand has returned to pre-9/11 levels. and the FAA now projects the nation's air transportation system will be serving over one billon passengers by 2015.

Tax revenues are not growing: Over the past five years domestic fares have fallen as a result of the growth of low-fare/low-cost airlines, changes in how passenger tickets are distributed and greater business-traveler price sensitivity. In addition, the greater use of smaller, regional jets by commercial carriers has added to the air traffic workload without a commensurate increase in revenue to the FAA.

These changes mean more people are flying but the revenues from the increased activity are not keeping up with the costs of providing needed services and funding projects. This development has significantly impacted the Airport and Airways Trust Fund, the fund that finances a significant portion of the FAA's capital programs and some of the agency's operational and equipment expenditures.

The FAA believes the lack of connection between trust fund revenues and the FAA's costs has created uneven financial impacts on users of the air transportation system: The FAA estimates that commercial users and passengers pay over 95 percent of the Trust Fund taxes but account for only about 73 percent of the costs with jet and turboprop general aviation flights consuming similar FAA and airspace resources as commercial operators but paying only a fraction of what commercial operators pay. The FAA concludes that general aviation drives approximately 16 percent of the costs of air traffic services. Nearly 10 percent is said to be related to high performance general aviation aircraft such as corporate jets, while 6 percent is related to piston general aviation aircraft. In contrast, the FAA assesses that general aviation currently contributes just over 3 percent of the revenue that flow into the Airport and Airway Trust Fund. The Administration's proposal would increase general aviation's share of the user taxes and fees to 11 percent — with 10 percent coming from jets and other high performance aircraft and 1 percent from piston users.

Administration Proposals for Financing FAA Capital and Operating Programs

The FAA Reauthorization Bill would change how FAA capital projects and operations would be financed. The FAA is proposing three funding sources for air traffic control services:

1. Turbine commercial flights would primarily pay user fees;

2. general aviation and all piston-powered flights would primarily pay fuel taxes; and

3. the General Fund would finance the costs of services provided to public users and other programs in the general public interest.

Rather than rely on the passenger ticket tax to fund the bulk of the Airport and Airways Trust Fund – as is currently the case – the Administration is proposing significant increases in general aviation and commercial fuel taxes to help fund the Trust Fund (which funds the AIP). Administration funding proposals include the following:

New User Fees: The Administration's bill would replace the current excise taxes on passengers with a new cost-based user fee system beginning in FY 2009. Under this proposal, jets and turboprops – including domestic, international, passenger, cargo, charter, air taxi and fractional operators (several operators of a single aircraft) – would pay user fees. General aviation and all piston-powered flights would continue to pay fuel taxes. Revenues from the users fees, along with a General Fund contribution and a portion of the revenue generated from the increased fuel taxes, would be used to fund the air traffic control system operations. The user fees would be periodically adjusted to cover the costs of providing air traffic control services.

New Financing Mechanism for the AIP: While AIP funding would still come from the Airport and Airways Trust Fund, the funding going into the trust fund would come from a huge increase in commercial and general aviation fuel taxes as well as revenue from reduced international arrival and departure taxes. Currently, about 70% of the trust fund revenue is generated from the 7.5% domestic passenger ticket tax and the domestic flight segment fee (a fee charged to airline passengers each time they take off from and land at an airport). The specific proposed tax increases and their distribution would be as follows:

- General Aviation Fuel Taxes: The Administration bill proposes to increase general aviation fuel taxes from the current 19.3 cents to 70 cents a gallon. Of that amount, 13.6 cents would be used to fund AIP, the Research, Engineering and Development (RE&D Program) and the Essential Air Service programs (a Department of Transportation program to provide a minimum level of air service to small communities through subsidies to air carriers, currently funded at $110 million a year). The remaining amount would be used to fund what the FAA assesses as general aviation's share of the air traffic control system.

- Commercial Fuel Tax: The proposal calls for raising the commercial fuel tax from the current 4.3 cents a gallon to 13.6 cents a gallon with all the revenue from this tax going to fund AIP, RE&D and the Essential Air Services programs. The commercial and general aviation fuel tax increases would go into effect on October 1, 2008 and would be adjusted for inflation beginning in 2010.

- International Arrival and Departure Tax: The proposal would reduce the international arrival and departure tax from the current $14.50 to $6.39 and use the revenue to fund for AIP, RE&D and the Essential Air Service programs.

Congressional Reaction

Congressional reaction to the Administration's proposal has been mixed. Congressional aviation subcommittees in both the House and the Senate have held several hearings on the bill. Overall, Congress has raised concerns in three critical areas:

1. The proposed reduction in AIP funding;

2. The proposed increase in user fees and fuel taxes; and

3. The proposed increase in the PFC ceiling.

Both houses of Congress have nearly completed their series of hearings on the bill. In late April, the Senate Aviation Subcommittee (a subcommittee of the Senate Commerce, Science and Transportation Committee) released a draft of its own FAA reauthorization bill. On May 16, the Senate Commerce, Science and Transportation Committee marked up its subcommittee's draft legislation and sent it to the Senate Finance Committee for further consideration of the revenue provisions in the bill. The bill is expected to go to the full Senate in this summer. In the areas of interest to San José, the Senate bill differs from the Administration bill in the following key areas:

1. An increase in AIP funding levels (3.8 billion in FY08, with one hundred million more in each subsequent fiscal year). Over the life of the bill, the legislation authorizes $15.8 billion for the AIP program (compared to $14.2 billion under Vision 100);

2. No increase in the PFC ceiling rate except a pilot program that would allow six airports to charge an unlimited PFC *provided* the airport collects the fee directly through a kiosk, the internet or other means but *not* through the airline ticket;
3. Would replace the current 4.3-cent fuel tax on commercial aviation with a $25 fee per departure to fund the commercial aviation's share of modernizing the air traffic control system;

4. No increase in fuel taxes. In addition, at least two Committee Senators expressed their commitment to work together to block any attempt to raise fuel taxes.

The Transportation and Infrastructure Committee of the House of Representative has not yet introduced its version of the bill but plans to do so sometime in early June.

Stakeholder Reaction

The reaction to the Administration's bill among the key stakeholders has been along predictable lines.

The airlines have opposed the bill's provision to increase user fees on commercial jets, arguing that it will drive up the costs of traveling for passengers though the commercial airlines believe they pay more than their fair share of FAA operating costs and support efforts to reallocate costs. The airline industry has also opposed raising the PFC ceiling from the current $4.50 arguing the additional money will address airport "wants" rather than airport "needs."

Public airport advocacy groups support an increase in PFC but urge the Administration to raise it to $7.50 instead of $6 on the grounds that a $6 PFC does not cover the buying power lost since the last increase in 2000. They would also like to see the PFC periodically and automatically raised for inflation. Airport advocacy groups also support increasing the AIP from current levels to account for inflation and the rise in construction costs. The Senate bill adopts the airport advocacy groups' proposal to raise the authorized level ($3.7 billion in FY07) to $3.8 billion and increase the authorized level by $100 million in each subsequent fiscal year.

The general aviation community has voiced strong opposition to the bill's proposal to raise fuel taxes for general aviation from the current 19.3 cents to 70 cents, believing such an increase is not justified and will hurt the economy by discouraging general aviation activity.

Key City Legislative Objectives

In determining its position on those parts of the reauthorization bill that have the most impact on SJC, staff recommends the City be guided by one overriding goal: to enhance SJC's ability to determine and address the needs of the traveling public that uses it. To achieve that goal the City should be guided by following six legislative objectives:

1. Increase the PFC ceiling rate.

2. Streamline the FAA's management of the PFC program.

3. Allow airports greater flexibility to use local sources of revenue.

4. Increase funding for the Airport Improvement Program.

5. FAA capital and operating programs should be funded by stable and predictable revenue streams.

6. Reduce capital financing costs for airports.

These objectives are supported by airport advocacy groups, like the American Association of Airline Executives and the Airports Council International of North America, and many individual airports across the nation. Staff believes the objectives reflect positions that would improve SJC's capability to determine the needs of its customers and tenants, to raise revenue to address those needs and to construct the capital projects that will better protect and serve the traveling public.

Recommended City Positions on the FAA Reauthorization Bill

After consideration of the Administration's proposed reauthorization bill for the FAA, the Senate bill, the Airport's current and long-term needs and other relevant information, staff recommends the City convey the following specific recommendations to its federal legislative delegation:

1. *Raise the PFC ceiling to $7.50 and index it to inflation.*

The ceiling for PFCs has not been raised since 2000. In the meantime, escalating construction costs have reduced the value of PFC revenues. While the Administration recommends a ceiling of $6, staff does not believe a $6 ceiling is sufficient to offset the combined effects of:

- the deflated value of the current PFC;
- the proposed elimination of AIP entitlement funding for large and medium hub airports like SJC; and
- increased capital costs faced by airports like SJC.

In an October 10, 2006 information report to the City Council, City staff noted the escalation in local construction cost had led to bids exceeding the Engineer's estimate by 15 to 20 percent. According to a study conducted by Airports Council International (ACI), the $4.50 PFC is now worth only $2.86 in 2007 dollars if the effects of construction cost escalation are applied. To fully recapture the value of the $4.50 PFC (authorized in 2000), the ceiling would have to be raised to $7.50. The new ceiling should be indexed to inflation to maintain its buying power over time.

The impact of raising the PFC ceiling rate for SJC would be significant. In FY 05-06 the Airport realized $22.2 million in PFC revenues from 5.4 million passenger tickets. If the PFC ceiling were raised to $6, based on the same passenger activity level, the Airport would have raised $29.8 million. If the PFC ceiling were $7.50, the Airport would have received $36 million.

2. *Streamline the PFC review process and expand the eligibility criteria.*

The current eligibility application process to use PFCs takes months and many hours of Airport and FAA staff to complete. The Administration's proposal intends to streamline the application process. Staff supports that proposed change.

In addition, staff supports the Administration's proposal to simplify and expand the range of projects that would be eligible for PFC funding. Under the Administration's proposal, if a project is an eligible use of airport capital and is not anti-competitive, it would be eligible for PFC funding. This would encourage greater local decision making and control to address local needs. That would strongly serve the interests of the City and the public that uses SJC. For example, expanding the eligibility criteria could address such important local improvements as an intermodal connection to the Airport, which is currently not eligible for PFC funding.

3. *Increase the funding for the Airport Improvement Program.*

Under Vision 100 (the current FAA reauthorization statute), the AIP was authorized to receive $14.2 billion over four years beginning with $3.4 billion in FY04 and increasing by $100 million per year through FY07. Under the current proposal, the Administration proposes funding AIP at $2.75 billion in FY 08 and increasing it by only $15 million a year for the next four years ($2.75 billion in FY08, $2.9 billion in FY09, $3.05 billion in FY10 and $3.2 billion in FY11).

The City should support continuing the funding of the AIP consistent with the levels authorized under Vision 100 ($3.7 billion in FY 2007), to reflect the impact of inflation, the rise in construction costs, and the increasing needs for airport capacity. While the Administration does propose to increase the amount of discretionary funding in the AIP from the current $148 million to $520 million, and staff supports that increase in funding, given the capital needs of airports across the nation, staff believes this is not the time to reduce the overall federal funding support for priorities of the national transportation system. The Senate bill provides for authorized AIP funding in the amounts of $3.8 billion in FY 2008, $3.9 billion in FY 2009, 4.0 billion in FY 2010 and $4.1 billion in FY 2011.

In addition, the elimination of AIP entitlement funding for large and medium hub airports, combined with reduced overall funding for the AIP could result in a greater reliance on PFCs to fund infrastructure priorities determined by the federal government. While the City should be prepared to give up its AIP entitlements for an increase in the PFC ceiling to $7.50, the Administration proposal that reduces or completely eliminates AIP entitlement funding for large and medium hub airports like San José, combined with an inadequate raise in the PFC ceiling and rising construction costs could leave the Airport in a more disadvantageous position than it is now.

Fully funding the AIP program (even if the entitlement funding is eliminated) should ensure adequate funding for needed priority national infrastructure capital projects.

In FY 05-06, the Airport received $2.3 million in AIP entitlement funding and $18 million in AIP discretionary funds. In FY 06-07, the City will submit another $8.4 million in funding requests for the ACT program, fire equipment and a Letter of Intent (LOI) payment for a runway project. The City has a strong interest in a fully funded AIP.

4. *Establish and maintain a predictable and stable revenue streams for FAA operating and capital programs.*

The federal General Fund contribution has been unpredictable and declining over the last 25 years. In 1981, the federal General Fund contribution to the nation's aviation programs was nearly 60% of the funding. (In 1984, it was over 65% of funding to aviation programs that benefit the public.) In 2007, the federal General Fund contribution to federal aviation programs is estimated to be 19%. (In 2000 and 2001 there was *no* federal General Fund contribution to federal aviation programs.) The federal General Fund support should be increased and stabilized.

To plan for and support long-term capital investment in airport infrastructure, and the next generation air traffic control system, the FAA and airports need a stable and predictable funding stream that does not unfairly allocate costs to any particular user group of the system and is supported by an equitable and guaranteed General Fund contribution. Staff believes the current discussion around who should pay what portion of the costs for FAA operating and capital programs is an appropriate discussion to have at this time. However, because the City is not in a position to determine how costs should be allocated within the national air transportation system, staff believes the City should take no specific position on this issue beyond supporting that such a discussion should take place and the commercial and general aviation communities should be allowed to weigh in with their comments and concerns.

5. Support treating airport bonds as tax-exempt public purpose bonds.

While this is not a provision in the Administration or Senate bill, it is important that bonds issued by publicly-owned airports, like SJC, not be classified as "qualified private activity" bonds and made subject to the Alternative Minimum Tax. For San José, the difference in financing costs can be significant. In 2004, SJC issued $216 million in bonds classified as "qualified private activity" bonds. Because the bonds were so classified, the Airport pays a .25% higher interest rate, which means an additional $12.8 million more in financing costs over the term of the issued debt. As another example, the Airport is currently preparing to issue $606 million in bonds in 2007 to support the Terminal Area Improvement Program. This will be one of the largest Airport bond issuances in California history. Because the bonds will be classified as "qualified private activity" bonds and the Airport is charged at a higher interest rate, the bonds will cost the Airport an additional $40.2 million in financing costs during the 40-year term of the debt. That will be $40.2 million that will not be available to build other Airport projects.

Conclusion

Staff believes the aforementioned recommendations will give SJC new tools to enhance its ability to determine its needs and to fund the implementation of the solutions to address those needs for a better airport for those who use it.

In late May, the Department of Transportation (DOT) released a report on the need to create more capacity in the national air system. That report stated the nation's busiest and metropolitan airports won't have enough capacity to meet projected demand over the next eighteen years unless they start building now. Since the funding for such a significant expansion has to come from some source, increasing, rather than decreasing, current primary funding sources is consistent with the DOT's goal of expanding the nation's airport capacity. The news release on the DOT report can be found at http://www.dot.gov/affairs/dot4807.htm .

POLICY ALTERNATIVES

Alternative #1: Take no action

Pros: None
Cons: City misses the opportunity to weigh in with its Congressional representatives on a major piece of aviation legislation that could have significant fiscal impacts on the Airport's capital program.
Reason for not recommending: Because of the potential implications for funding capital projects in the rebuilding of the airport, it is incumbent on the City to convey its comments and concerns to its federal legislative delegation.

Alternative #2: Amend any or all of staff's recommendations

Pros: Offers more acceptable solutions for the Congressional delegation to present in the legislative process.
Cons: Reduces the City's opportunity to achieve maximum outcomes.
Reason for not recommending: Reauthorization legislation for the FAA is considered by Congress only once every four years. Since the City will have to operate under whatever reauthorization legislation is passed by Congress and approved by the President for at least four

years, the City should ask Congress to support those solutions that it concludes will maximize the achievement of the City's desired legislative objectives. The positions recommended by staff are meant to achieve that objective.

PUBLIC OUTREACH/INTEREST

☐ **Criteria 1:** Requires Council action on the use of public funds equal to $1 million or greater. **(Required: Website Posting)**

☐ **Criteria 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**

☐ **Criteria 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This item meets Criteria 2. At its meeting of June 4, the Airport Commission unanimously approved staff's recommendations.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office, the Intergovernmental Relations staff of the City Manager's Office and the City's Washington legislative consultant firm of Patton Boggs.

CEQA

Not a project.

WILLAM F. SHERRY, A.A.E.
Director of Aviation
Airport Department

For questions please contact James Webb, Jr., Director of Government Relations at (408) 501-7600