
SUMMARY

Operating costs for Minneapolis-St. Paul International Airport are low in comparison with other large hub airports across the United States. In addition, the Metropolitan Airports Commission appears to have exercised more fiscal restraint than most other airports did in response to the events of September 11, 2001. We are concerned, however, that commission staff initially proposed a 12 percent increase in operating expenses, excluding depreciation, for 2003. Although the commission ultimately reduced the increase to less than 6 percent and used 2002 operating income to keep airline charges from increasing, we think that the staff proposal was out of step with the financial distress being experienced in the airline industry. While some increase in the budget may be needed due to increased costs and the expansion of the airport, we do not feel MAC staff provided a convincing case for the increase. MAC also needs to focus attention on its concession revenues. Available data suggest that the commission is currently receiving rents from food, beverage, and retail concessionaires that are about one-fourth lower than those at other large airports.

Immediately following the terrorist attacks on September 11, 2001, passenger traffic at airports across the country dropped dramatically. The nation's major airlines, which had already been losing money due to the recession, suffered dramatic financial losses. Both the federal government and airport authorities came under pressure to improve airport security and provide financial relief to the airlines. The United States Congress passed legislation to provide \$5 billion in financial grants to the airline industry and instituted a ticket tax to pay for mandated security improvements at the nation's airports.

The financial crisis in the airline industry has brought increased interest in MAC and its budget.

In Minnesota, legislative committees held hearings to discuss the impact on airline companies headquartered in the state and on the workers that had been laid off. The Metropolitan Airports Commission (MAC) implemented a hiring freeze and reduced its operating budget for 2002. MAC also postponed a large portion of the capital projects planned for 2002, as well as some projects scheduled for the remainder of 2001.

Some legislators were disappointed, however, with MAC's responsiveness to the financial crisis in the airline industry. The 2002 Legislature considered changes to bring MAC and its budget under greater legislative scrutiny. Although legislation

did not pass during the 2002 legislative session, questions remain about MAC's finances. This chapter attempts to address some of those questions. In particular, we examine the following issues:

- **How have the costs of operating the Minneapolis-St. Paul International Airport (MSP) changed over the last decade? How does MSP compare with other airports in terms of its operating costs and airline rates and charges?**
- **How did the Metropolitan Airports Commission respond through its operating budget to the financial distress in the airline industry following the terrorist attacks on the United States in September 2001? How did MAC's response compare with those of other large airports across the nation? In preparing a 2003 budget, has MAC been appropriately responsive to the needs of the airline industry?**
- **How did the Metropolitan Airports Commission change its capital budget in response to the financial crisis in the airline industry? How well has MAC controlled the costs of implementing the 2010 plan for expanding the Minneapolis-St. Paul International Airport?**
- **How do the revenues raised by MAC from sources other than airlines compare with those raised at other large airports across the country? Are there ways for MAC to enhance non-aeronautical revenues such as concession revenues?**

TRENDS AND COST COMPARISONS

Airports are often compared by examining airport operating costs and the amounts they charge airlines.

In the airline industry, two measures are often used to examine airport cost trends and compare airports. The measure most frequently used is the rates and charges airlines pay to an airport per “enplaned” passenger.¹ For airports, this measure reflects the revenues raised from airlines, which are typically based on portions of both the airport's operating costs and its prior capital investments. The airline cost per enplanement is generally higher for airports that have undertaken large capital projects in recent years. The cost per enplanement can also be higher for airports that are less efficiently operated.

A second measure is the airport's operating costs per enplaned passenger. Operating costs include all operating expenses except depreciation. This measure focuses on how efficiently an airport is operated regardless of how operations are financed. It also excludes any consideration of capital costs.

¹ An airport's “enplaned” passengers—or enplanements—represent the number of passengers departing on flights from that airport.

Airline Rates and Charges

Generally,

- **Airline rates and charges per enplaned passenger have been low at Minneapolis-St. Paul International Airport compared with other large hub airports.**

According to data obtained from the Federal Aviation Administration (FAA), the airlines' cost per enplanement at MSP was 43 percent below the average cost at large hub airports in the United States in 2000.² Because costs at a few airports were considerably higher than those at others, it is also useful to compare MSP's costs to the median cost figure. Table 2.1 shows that the airline cost per enplaned passenger at MSP was 12 percent below the large hub median in 2000 and was the 23rd highest among the 31 airports classified as large hub airports. Only eight other large hub airports had lower airline charges per passenger. Landing fees at MSP were only slightly below the median for large hub airports, but the terminal rents charged by MSP were more than 50 percent below the median and were the 4th lowest among the 31 airports.

In 2000, airline costs per passenger at MSP were lower than those at two-thirds of the nation's large airports.

Table 2.1: Airline Rates and Charges per Enplanement, MSP Compared With Other Large Hub Airports, FY 2000

Type of Charge	MSP	Large Hub Average	Percentage Difference From Average	Large Hub Median	Percentage Difference From Median	MSP's Rank
Landing Fees	\$2.34	\$2.99	-22%	\$2.47	-6%	17th highest of 31
Terminal Fees	1.36	3.65	-63	2.89	-53	28th highest of 31
Other Charges	<u>0.84</u>	<u>1.30</u>	-35	<u>0.92</u>	-8	18th highest of 31
Total Rates and Charges	\$4.53	\$7.94	-43%	\$5.13	-12%	23rd highest of 31

SOURCE: Office of the Legislative Auditor's analysis of data from the Federal Aviation Administration.

Data from the Metropolitan Airports Commission also show that the growth in airline payments during the 1990s was roughly consistent with the growth in passengers at MSP and nationwide inflation. Although airline payments at MSP grew more than 150 percent from 1990 to 2000, the airline cost per enplanement at MSP grew only 6 percent during that period when adjusted for inflation.³

Nationwide data for 2001 are not yet available for airport comparison purposes, but data from MAC indicate that costs per enplanement increased significantly at

² The Federal Aviation Administration defines a large hub airport as one that has one percent or more of the nation's total enplaned passengers. For 2000, airports with 7,102,994 or more enplaned passengers were classified as large hub airports.

³ We adjusted for inflation using the implicit price deflator for state and local government expenditures published by the U.S. Department of Commerce. This price index increased 33 percent between 1990 and 2001.

MSP in 2001. The airline cost per enplaned passenger rose 17 percent during 2001. Close to three-fourths of this increase can be explained by inflation and the largely unanticipated decline in passengers in 2001. The remainder of the increase reflects growth in MSP’s operating costs and the early stages of implementation of its 2010 plan for expanding the airport. It remains to be seen how MSP will compare with other airports for 2001. The decline in passengers at MSP during 2001 appears to have been about average for large hub airports, but it is unclear at this time how MSP’s growth in airline costs compared with other airports.

In future years, airline costs per enplaned passenger are likely to grow at MSP. Metropolitan Airports Commission staff have projected that airline costs per enplanement will increase 41 percent between 2001 and 2010.⁴ This expected growth is due in large part to the planned expansion of the airport. How this growth will affect MSP’s relative rank among large hub airports is unknown, since other airports may also be undertaking significant capital projects.

Airport Operating Costs

It is also useful to track trends and compare airports using an airport’s operating costs per enplaned passenger. In this regard,

- **MSP has typically had relatively low operating costs per enplaned passenger.**

In 2000, airport operating costs per enplaned passenger were 44 percent below the average for large hub airports. As Table 2.2 shows, MSP’s operating costs per enplanement were the fifth lowest among the 31 airports and 37 percent below the median cost for large hub airports. This figure indicates that MAC has generally run an efficient operation at MSP in comparison with most other large airports.

In 2000, only about one-eighth of the nation’s large airports had lower operating costs per passenger than those at MSP.

Table 2.2: Airport Operating Expenses per Enplanement, MSP Compared With Other Large Hub Airports, FY 2000

Type of Expense	MSP	Large Hub Average	Percentage Difference From Average	Large Hub Median	Percentage Difference From Median	MSP’s Rank
Personnel Expenses	\$2.35	\$3.14	-25%	\$2.57	-9%	18th highest of 31
Non-Personnel Expenses	<u>2.43</u>	<u>5.39</u>	-55	<u>5.22</u>	-53	26th highest of 31
Total Operating Expenses	\$4.78	\$8.53	-44%	\$7.56	-37%	27th highest of 31

SOURCE: Office of the Legislative Auditor’s analysis of data from the Federal Aviation Administration.

⁴ This projection was not adjusted for inflation that may occur during that period of time. The growth in enplaned passengers was also conservatively estimated—6 percent between 2000 and 2010. Enplanements for 2002 are currently running ahead of estimates.

Between 1990 and 2001, MAC's operating costs, excluding depreciation, grew 130 percent—from \$39.4 million to \$90.6 million.⁵ Roughly half of the increase was due to increased spending on employee salaries and benefits. Between 1990 and 2001, the number of staff at MAC grew close to 50 percent. Much of that increase occurred between 1993 and 2001—a period for which data on the type of staff added are available. Table 2.3 indicates that a significant portion of the increase in staff occurred in the following areas: maintenance and trades, police

Between 1993 and 2001, the number of staff at MAC grew 42 percent.

Table 2.3: Number of Full-Time Equivalent Staff at the Metropolitan Airports Commission, 1993-2001

Department	1993	1997	2001	Change in Number of Staff, 1993-2001	Percentage Change, 1993-2001
Administrative Functions					
Executive/Commissioner	3	3	3	0	0%
Deputy Planning	2	2	2	0	0
Deputy Administrative Services	3	3	4	1	33
Deputy Human Resources	10	14	15	5	50
Public Affairs	3	3	3	0	0
Air Service-Business Development	0	3	2.5	2.5	N/A
Airport Insurance/Safety	2	3	3.5	1.5	75
Airport Development/Building Official	9	10	20	11	122
Finance/Purchasing	19	18	21	2	11
Internal Audit	0	2	2	2	N/A
Information Systems	7	6	16	9	129
Legislative and Labor Relations	3	3	4.5	1.5	50
Commercial Management/Airline Affairs	5	4	9	4	80
General Counsel	4	4	7	3	75
Subtotal: Administrative Functions	70	78	112.5	42.5	61%
Operations					
Deputy Operations	4	2	2	-2	-50
Airport Director's Office	7	5	5	-2	-29
Conference Center	0	0	5.5	5.5	N/A
Airside Operations	8	9	12	4	50
Communications	9	11	14	5	56
Landside Operations	3	17	26.5	23.5	783
Fire	37	38	45	8	22
Police	73	73	94	21	29
Aviation Noise/Environment	15	13	12	-3	-20
Airline Operations/Facilities	1	1	2	1	100
Lindbergh Terminal Facilities	16	11	14	-2	-13
Energy Management Center	12	13	17	5	42
Trades	24	28	35	11	46
Maintenance	73	84	113	40	55
Reliever Airports	27	27	28	1	4
Subtotal: Operations	309	332	425	116	38%
Totals	379	410	537.5	158.5	42%

SOURCE: Metropolitan Airports Commission.

⁵ After adjusting for inflation, the increase in operating expenses (excluding depreciation) was 73 percent between 1990 and 2001.

MSP's inflation-adjusted operating costs per passenger have not increased much since 1990.

and fire, and airport capital development. In addition, MAC increased its staff when it took on new areas of responsibility in the landside operations area and in its new conference center.⁶ The other half of the growth in spending resulted from increased expenditures on utilities, maintenance parts and supplies, and operating services such as the management of parking facilities and the provision of shuttle bus services.

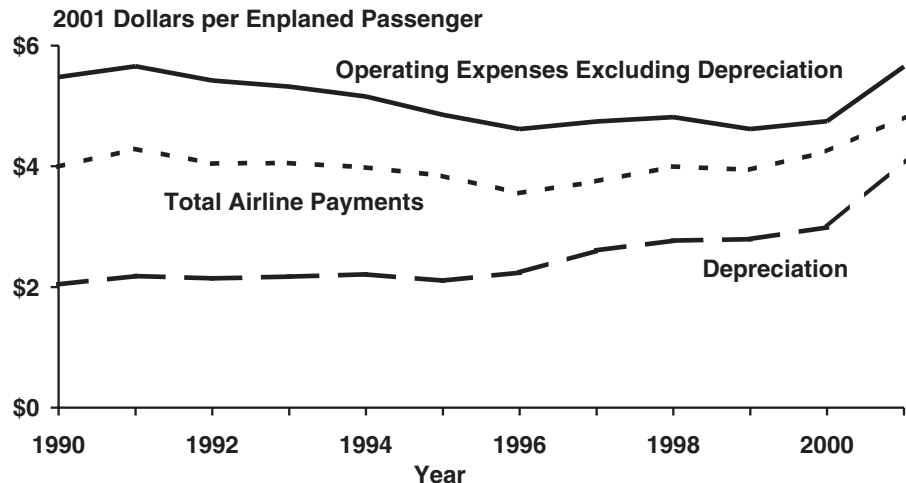
The increased use of the airport and the expansion of airport facilities, as well as inflation, have played a role in increasing the costs of operating the Minneapolis-St. Paul International Airport. Between 1990 and 2001, the number of enplaned passengers at MSP grew 67 percent while the number of aircraft operations—or aircraft arrivals and departures—increased 31 percent. In fact:

- **The operating costs per enplaned passenger at MSP—when adjusted for inflation—increased only 3 percent from 1990 to 2001.**

As Figure 2.1 shows, inflation-adjusted operating costs per enplaned passenger were generally decreasing until 2001. They fell 13 percent between 1990 and 2000. But, in 2001, a 12 percent increase in operating expenses along with a 9 percent decrease in enplanements caused operating costs per enplanement to rise 19 percent after adjusting for inflation.

Costs per enplanement may fall slightly during 2002 when adjusted for inflation. MAC decreased its operating budget for 2002 by 6 percent. Through September

Figure 2.1: MAC Operating Expenses, Depreciation, and Airline Payments per Enplaned Passenger (in 2001 Dollars), 1990-2001



SOURCE: Office of the Legislative Auditor's analysis of data from the Metropolitan Airports Commission.

⁶ Landside staff oversee parking facilities, ground transportation including taxi permitting and starting, commercial vehicle access, and contracted shuttle bus services. They also monitor usage of MSP roadways and the transit hub and provide the traveling public with information and assistance at the airport.

2002, enplanements were about 5 percent below 2001 levels. Data are not yet available to show how MSP's operating costs per enplanement during 2001 and 2002 compared with other large airports, but many of those airports also experienced a drop in passengers.

OPERATING BUDGET

In this section, we examine how MAC adjusted its operating budget following the events of September 11, 2001, which caused passenger traffic and operations at the Minneapolis-St. Paul International Airport to decline significantly. We also compare MAC's response to those of other airports.

MAC Response to September 11th

During 2001, MAC implemented a partial hiring freeze and reduced non-essential spending.

Even prior to the events of September 11, 2001, the Metropolitan Airports Commission was facing significant budget problems for 2001. Passenger traffic and operations at MSP were down due to the economic downturn. As a result, MAC revenues were below expectations. In addition, actual expenditures were exceeding budgeted amounts, due in part to heavy snowfall during early 2001 and large increases in utility costs. MAC implemented a hiring freeze on non-essential staff positions, curtailed travel, directed managers to minimize consultant spending, and canceled or delayed purchases of equipment. Following September 11, 2001, MAC continued to seek ways to reduce and control its spending during 2001. Ultimately, MAC's operating expenses—not including depreciation—were \$90.6 million for 2001. This figure was lower than feared early in the year but still higher than the original budget of \$88.6 million.

Following the events of September 11, 2001, MAC also reworked its proposed budget for 2002. In December 2001, MAC adopted a budget of \$85.4 million (excluding depreciation), which was a reduction of close to 6 percent from actual spending in 2001.⁷ The budget included no increase in the number of full-time equivalent staff and no salary increases for non-unionized employees for the first six months of 2002. As Table 2.4 shows, actual spending reductions were budgeted in every major area. The overall operating budget increased 4 percent because depreciation expenses grew 17 percent. We think it is appropriate to exclude depreciation when examining MAC's efforts to control operating costs, since it simply reflects the amount of past capital project activity. MAC's efforts to control its capital project costs are discussed later in this chapter.

It appears that MAC's actual spending during 2002 will be close to the amount budgeted. MAC approved a 3 percent wage increase for non-unionized employees effective July 1, 2002, due to better than expected revenues from parking and other concessions. Actual spending for the year was projected at the end of November 2002 to be about equal to budgeted expenses, while revenue was expected to exceed the budgeted level by close to 4 percent.

⁷ It should be noted, however, that the 6 percent reduction in 2003 operating expenses (excluding depreciation) followed a 12 percent increase in 2002.

Table 2.4: Operating Expenses (in \$1,000s) for the Metropolitan Airports Commission, 2000-2002

Type	2000	2001	Percentage Change: 2000-01	2002 Budget	Percentage Change: 2001-02
Personnel	\$ 39,814	\$ 42,627	7%	\$ 41,581	-2%
Administrative	1,686	1,708	1	1,172	-31
Professional Services	6,357	5,177	-19	3,954	-24
Utilities	8,678	11,208	29	10,755	-4
Operating Services	11,971	14,113	18	12,925	-8
Maintenance	12,238	15,250	25	14,343	-6
Other	278	521	87	623	20
Subtotal: Operating Expenses Excluding Depreciation	\$ 81,022	\$ 90,604	12%	\$ 85,353	-6%
Depreciation	\$ 51,028	\$ 65,647	29%	\$ 76,518	17%
Total Operating Expenses	\$ 132,050	\$ 156,251	18%	\$ 161,871	4%

MAC reduced its operating expenses (excluding depreciation) by 6 percent in 2002.

SOURCE: Metropolitan Airports Commission.

In October 2002, MAC staff released a proposed budget for 2003 that was significantly higher than the 2002 budget. The proposal included an overall increase of 10 percent and an increase of 12 percent for operating expenses excluding depreciation. Airline representatives were displeased with the size of the increase at a time when airlines are continuing to lose money and cut costs and personnel. They proposed a budget with no increase in operating expenses excluding depreciation. At the direction of MAC's Finance Committee, MAC staff is working to reduce the size of the budget increase. We discuss the proposed 2003 budget later in this chapter.

Comparison With Other Airports

To place MAC's budget reduction efforts in perspective, we contacted a number of airports to see how MAC's response to the airline industry's financial distress compared with those elsewhere. Our sample of airports included 22 airports from various regions of the United States. For the most part, our sample consisted of large hub airports, but we also included five medium hub airports that we were told had made significant budget cuts. In comparing airports, it is important to understand that airports experienced somewhat different trends in passengers and operations as a result of the recession and the events of September 11, 2001. Data suggest, however, that experience at MSP is similar to that of airports in our sample. From 2000 to 2001, the number of passengers at the Minneapolis-St. Paul International Airport declined 7 percent, according to Airports Council International-North America. The decline at MSP is nearly identical to the median decline for airports in our sample (6 percent), although their experience ranged from a decline of 13 percent to an increase of less than 1 percent. Aircraft operations declined 4 percent at MSP between 2000 and 2001 compared with a median decline of 5 percent among airports we contacted. The change in operations ranged from a 12 percent decline to a 2 percent increase.

In analyzing the fiscal response of airports to the events of September 11, 2001, we focused on airport operating expenses (excluding depreciation). We relied as much as possible on actual spending and used budgeted amounts only for any fiscal year not yet completed. We found that airports often reported they made budget cuts when, in fact, they only reduced spending from a proposed budget and actually increased spending from the amount spent during the previous fiscal year.

As Table 2.5 shows, we found:

- **MAC reduced its operating expenses more than most other airports did during fiscal year 2002.**

Table 2.5: Change in Operating Expenses (Excluding Depreciation) at U.S. Airports, FY 2001-02

MAC has shown more fiscal restraint than most other airports.

<u>Airport</u>	<u>Percentage Change</u>
Detroit	25%
Houston	23
Newark	14
Chicago-Midway	13
Philadelphia	10
Memphis	10
Milwaukee	8
Miami	8
Dallas/Ft. Worth	5
Chicago-O'Hare	1
Cleveland	0
Tampa	0
Seattle	-2
St. Louis	-4
Denver	-4
Boston	-5
Atlanta	-6
Minneapolis-St. Paul	-6
Los Angeles	-7
Jacksonville	-11

SOURCE: Office of the Legislative Auditor's phone survey of airports, July-September 2002.

Only two airports reduced their operating expenses more than MAC did from fiscal year 2001 to fiscal year 2002. Jacksonville reduced its operating expenses (excluding depreciation) by 11 percent, and Los Angeles International Airport reported a spending reduction of 7 percent. The Atlanta airport reduced its expenses by 6 percent—the same reduction made by MAC—while six other airports reported smaller reductions. Of the 19 airports providing sufficient information, the median budget change was a 1 percent increase.

Because MAC significantly increased its operating expenditures in 2001, we also examined the rate of growth in spending over a two-year period. We compared the spending increase at MAC between 2000 and 2002 with spending increases at other airports. Even then, MAC's increase of 5 percent over a two-year period was less than the increases of all but one of the airports in our sample. (See Figure 2.2.) The increase at Seattle's airport was only 2 percent, while the median

increase for our sample of airports between fiscal years 2000 and 2002 was 12 percent.

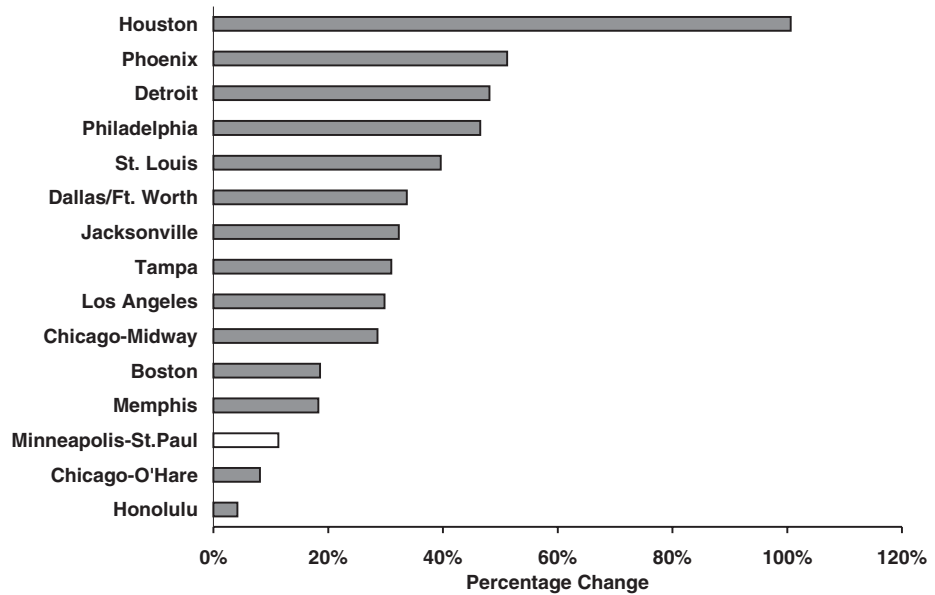
In light of the large increase MAC staff initially proposed for 2003, we also compared increases between fiscal years 2000 and 2003. In comparing increases, we used the 6 percent increase ultimately adopted by the commission for 2003. As Figure 2.3 shows, only 2 of the 14 airports responding to our survey had lower increases in spending over this three-year period. MAC's increase totals 11 percent over that period, while the median increase at other airports is 32 percent.

Figure 2.2: Change in Operating Expenses (Excluding Depreciation) at U.S. Airports, FY 2000-02



SOURCE: Office of the Legislative Auditor's phone survey of airports, July-September, 2002.

Figure 2.3: Change in Operating Expenses (Excluding Depreciation) at U.S. Airports, FY 2000-03



NOTE: The change for MSP is based on the commission's adopted budget for 2003.

SOURCE: Office of the Legislative Auditor's phone survey of airports, July-September 2002.

We also examined some of the more detailed ways in which MAC and other airports responded in their spending and employment to airline industry financial problems. Like 82 percent of the airports responding to our inquiries, MAC instituted a hiring freeze. Most exempted security employees, and some also exempted other essential employees; MAC exempted security and other essential employees. The hiring freeze is still in effect at MAC, but it is no longer in effect at 39 percent of the airports that initially had one. Despite the freeze, the number of full-time employees at MAC grew 4 percent from just prior to September 11, 2001 to a year later. The median increase for airports responding to our phone survey was 1 percent. MAC attributes its staff increase to the 10 additional police officers and 11 community service officers hired to meet the new federal mandates for airport security.⁸

MAC did not lay off any employees but neither did 73 percent of the airports that we contacted. Six airports reported layoffs, but only one laid off more than 4 percent of its workforce. Officials at Logan International Airport in Boston reported layoffs of more than 10 percent.

Unlike MAC, about two-thirds of the airports in our sample did not institute a salary freeze following September 11, 2001. Of the seven airports that reported a salary freeze, four applied it to all employees, while two only applied it to some senior managers. One airport applied the freeze only to non-unionized employees, just as MAC did. Each of the seven airports imposed the salary freeze for a longer period than MAC's six-month freeze.

Unlike MAC, which froze non-union salaries for six months, most airports did not implement a salary freeze.

⁸ MAC may be able to recover the salary costs related to increased airport security requirements from the federal Transportation Security Administration.

Although MAC was criticized for not reducing its rates and charges to airlines following September 11, 2001, only 19 percent of the airports in our survey reported that they had reduced rates such as landing fees and terminal rents. Special circumstances seem to explain at least three of the four cases in which reductions occurred. One airport financed the reduction using monies from a large unreserved cash fund. Another financed rate cuts for 2002 using over-recovered rates and charges from 2001. A third airport reported that it would finance the cuts using budget reductions but, if the reductions are not sufficient, it will bill the airlines at the end of the year to recover any costs that the new rates do not recover.

Northwest's Request to Park Airplanes

Northwest Airlines asked MAC for help in responding to the 9/11 crisis.

One of the concerns raised by Northwest Airlines following September 11, 2001 was about MAC's failure to respond in a timely and positive way to the company's need to temporarily park some aircraft. Specifically, on October 1, Northwest Airlines (NWA) asked MAC management if it could park 30 to 45 aircraft at Minneapolis-St. Paul International Airport free for a period of up to about nine months. NWA did not expect to fly all of its planes once air travel resumed after the suspension of flights on September 11 and needed temporary space to store them before selling them or permanently storing them elsewhere.



Northwest Airlines requested free parking at MSP for a number of aircraft following the events of September 11, 2001.

MAC management verbally rejected Northwest's request on October 9 given the need to park charter aircraft in the only area available for parking that many planes.⁹ Two days later, Northwest Airlines officials again asked MAC management what MAC could do to help the airline with its parking needs. In particular, Northwest officials asked if MAC would provide free parking for about 15 aircraft that could be activated on a daily basis if needed. MAC managers did not meet with Northwest Airlines officials until October 29 to discuss a low-cost alternative plan. Northwest continued to request free parking. On November 13, 2001, MAC management sent Northwest Airlines a letter offering a 700 by 150 foot parking area at \$1,750 per month, which MAC management said would cost substantially less than the \$60,000 per month that would normally be charged to airlines for similar space.¹⁰ By that time, NWA's needs had already been addressed at the Detroit airport and elsewhere across the country. NWA would have preferred to park some of its planes at MSP where mechanics would be readily available to work on them if needed. NWA parked about 10 to 12 planes

⁹ Parking was available at the ramp adjacent to the site where the new Federal Express building was to be built at MSP.

¹⁰ Northwest Airlines made its request to MAC management in an October 1, 2001 letter. MAC management says the request was mentioned briefly at an October 3 meeting of the commission's finance committee, although no mention of the request is included in meeting minutes. Minutes indicate that the request was mentioned at a November 7, 2001 meeting of the commission's management and operations committee.

for free on a taxiway at the Detroit airport for a period of two to six weeks before selling them or moving them to more permanent storage.

In our opinion:

- **MAC management should have placed a higher priority on accommodating Northwest Airlines' needs to park aircraft following the events of September 11, 2001.**

MAC's response to Northwest Airlines' request for free aircraft parking should have been more timely.

Although the period following September 11 was clearly a difficult period for the airlines and airport operators, MAC should have responded more quickly to NWA's request. MAC's executive director acknowledged to us that the agency failed to respond in a timely manner.

It should be understood, however, that MAC staff may have had legitimate concerns about offering free parking. MAC management was concerned that providing free parking would set a precedent and would cause other airport users—such as other airlines, taxicabs, and concession operators—to expect rate or rent reductions. In addition, Minneapolis-St. Paul International Airport has limited space compared with other airports. As a result, the airport has had a tradition of making users pay for the use of space. This philosophy has worked to the benefit of Northwest Airlines in some instances. Charter planes, unlike NWA planes, are typically parked at the airport several days each week and pay parking fees for the use of the space immediately adjacent to the space NWA could have used at MSP. From the perspective of MAC staff, NWA was essentially asking for an exception to the rules that MAC staff believe NWA has supported in the past.

The situation at the Detroit airport was also somewhat unique. Aircraft are generally not parked on a taxiway for any extended period of time because taxiways are used on a regular basis by planes moving to and from runways. The taxiway in Detroit was, however, infrequently used. Parking on this taxiway only affected NWA's operations by blocking access to its own hangar at one end. The effect on operations was limited since access to the hangar was still available from the other end.

MAC staff say that a parking arrangement similar to that at Detroit was not available at MSP. Nevertheless, given the unprecedented challenges faced by the airlines after September 11, MAC should have responded with more urgency and should perhaps have been willing to make a brief exception to usual practices.

Proposed 2003 Budget

As shown in Table 2.6, in September 2002, the executive director of the Metropolitan Airports Commission proposed a 12 percent increase in MAC's operating budget (excluding depreciation) for 2003. Because the airline industry had significant financial losses in 2001 and their financial troubles were continuing in 2002, the airlines serving the Minneapolis-St. Paul International Airport requested that MAC keep its 2003 operating budget (excluding depreciation) at the same level as it was in 2002.¹¹

¹¹ The airlines' request came after MAC staff presented their initial budget proposal to the commission in October 2002.

Table 2.6: Budgeted Operating Expenses (in \$1,000s) for the Metropolitan Airports Commission, 2002-2003

Despite the airline industry's continuing financial problems, MAC staff proposed a 12 percent increase in operating expenses for 2003.

Type	2002 Budget	2003 Budget Initially Proposed by MAC Staff	Proposed Percentage Change: 2002-03	2003 Budget Approved by the Commission	Percentage Change: 2002-03
Personnel	\$ 41,581	\$ 45,512	9%	\$ 42,568	2%
Administrative	1,172	1,034	-12	1,014	-13
Professional Services	3,954	4,068	3	3,680	-7
Utilities	10,755	11,372	6	11,274	5
Operating Services	12,925	14,203	10	13,364	3
Maintenance	14,343	17,397	21	16,716	17
Other	623	1,598	157	1,585	154
Subtotal: Operating Expenses Excluding Depreciation	\$ 85,353	\$ 95,184	12%	\$ 90,201	6%
Depreciation	\$ <u>76,518</u>	\$ <u>82,956</u>	8%	\$ <u>80,805</u>	6%
Total Operating Expenses	\$161,871	\$178,140	10%	\$171,006	6%

SOURCE: Metropolitan Airports Commission.

The commission reduced the staff-proposed increase of 12 percent to less than 6 percent when it adopted a budget in mid-December 2002. The 6 percent increase includes no increase in the number of MAC staff and no salary increase for MAC's non-unionized employees who comprise slightly more than half of the staff. The commission is also using \$3.3 million from its 2002 operating income to keep the estimated amount of fees and charges to be paid by the airlines from increasing between 2002 and 2003.¹²

Despite MAC's relatively low costs compared with those at other airports, there have been some general concerns about MAC's budgeting process, as well as specific concerns about the size of the proposed increase for 2003. Concerns have been raised by the airlines about the need for MAC staff to involve the airlines in a more cooperative way in developing the proposed budget to be presented to the commission. In past years, although less so this year, the airlines have complained about the limited length of time available to review and comment on the proposed budget prior to its adoption by the commission. In addition, there is the question of whether MAC's budget should be subject to legislative review. These issues are dealt with in Chapter 5.

Like the airlines serving the Minneapolis-St. Paul International Airport:

- **We are concerned that the staff for the Metropolitan Airports Commission proposed a significant increase in the agency's 2003 operating expenses during a time that the airlines are incurring significant losses.**

¹² MAC's operating income is calculated by subtracting its operating expenses, including depreciation, from its operating revenues.

The staff's budget request was not adequately justified and was reduced by the commission.

Although the proposed 12 percent increase was ultimately reduced by the commission, we think that the current process needs improvement by MAC and additional oversight by the Legislature. We are somewhat sympathetic to MAC's predicament of having expanded the size of its facilities at MSP while now being asked to hold the line on expenses. But we think that MAC staff have not provided adequate information to show how the expanded facilities contribute to increased expenses.

More generally, we think that the format of the documents outlining the proposed budget needs some improvement. In particular, it is difficult to determine the exact basis for some proposed spending increases, as well as the rationale. Some explanation of the increase in each major spending category is provided, but it can be difficult for the commission and interested parties to determine how much of the increase is due to various factors.

For example, in the initially proposed budget for 2003, MAC staff proposed a \$3.1 million increase in maintenance spending.¹³ This was a 21 percent increase from 2002 and represented close to one-third of the overall proposed increase. The proposed budget document explained that repairs and supplies by trades workers were increasing \$0.3 million due to the reinstatement of repairs deferred from 2002 and the growth in terminal space with the expansion of Concourse C and the addition of Concourses A and B. The document also mentioned that many of the increases were directly related to new government requirements, such as security, and the expiration of warranties. But the document failed to provide details on exactly how much of the increase is due to various factors. In particular, it did not provide information on the amount of the increase that is due to security requirements or to the growth of facilities. In addition, it failed to explain why the growth of facilities is having an almost immediate impact on repair work. New facilities would appear less likely to require repairs than older parts of the airport.

We recommend that:

RECOMMENDATION

In future proposed budgets, the Metropolitan Airports Commission staff should provide more detailed explanations of the source of, and rationale for, increases in its operating expenses.

CAPITAL BUDGET

In this section, we examine how MAC changed its capital budget in response to the events of September 11, 2001. We also review how MAC has managed the costs of the 2010 plan. First, however, it is important to put MAC's capital spending in perspective. As Table 2.7 shows, MAC's capital spending per

¹³ Maintenance spending includes the materials, equipment, and supplies used to maintain and repair terminal and other buildings and to remove snow from the runways, roads, and parking facilities. Contracts for cleaning services are also included. MAC's personnel costs for maintenance are not included in this spending category.

Table 2.7: Airport Capital Expenditures, Debt, and Debt Service Coverage, MSP Compared With Other Airports

Type of Charge	MSP	Average for Other Airports	Percentage Difference From Average	Median for Other Airports	Percentage Difference From Median	MSP's Rank
Capital Expenditures per Enplanement (2000)	\$27.27	\$9.84	177%	\$7.44	267%	3rd highest of 31 large hub airports
Debt per Enplanement (Projections from Moody's prior to September 11, 2001)	68.86	N/A	N/A	51.33	34	N/A
Debt Service Coverage Ratios (Projections from Moody's prior to September 11, 2001)	1.51	N/A	N/A	1.98	-24	N/A

SOURCES: Office of the Legislative Auditor's analysis of data from the Federal Aviation Administration; and Metropolitan Airports Commission, *2002 Operating Budget*, 286.

Due to the implementation of the 2010 plan, MAC's capital spending and debt are well above industry averages.

enplaned passenger in 2000 was significantly higher than the average for large hub airports. This reflects the fact that MAC has been in the process of implementing the 2010 plan for expanding the Minneapolis-St. Paul International Airport.

As a result of the airport's expansion, MAC's outstanding bonded indebtedness has grown from just \$0.3 billion at the end of 1997 to \$1.6 billion at the end of 2001. According to data from Moody's—a leading bond rating firm—MAC's debt per enplaned passenger was about 34 percent higher than that for all large airports. MAC's debt coverage ratio—which is an indication of an airport's ability to pay debt—was about one-fourth lower than the industry average in 2001 just prior to the events of September 11, 2001.

Despite the large increase in debt and the recent distress in the airline industry, MAC's bonds have retained fairly high ratings. As of mid-September 2002, both Fitch and Standard & Poor's rated MAC's airport revenue bonds AA-. Only two other airports received a higher rating by Fitch, and none received a higher rating from Standard & Poor's.

MAC Response to September 11

Overall:

- **The airlines serving the Minneapolis-St. Paul International Airport have been pleased with how the Metropolitan Airports Commission reduced its capital budget for 2002 following the events of September 11, 2001.**

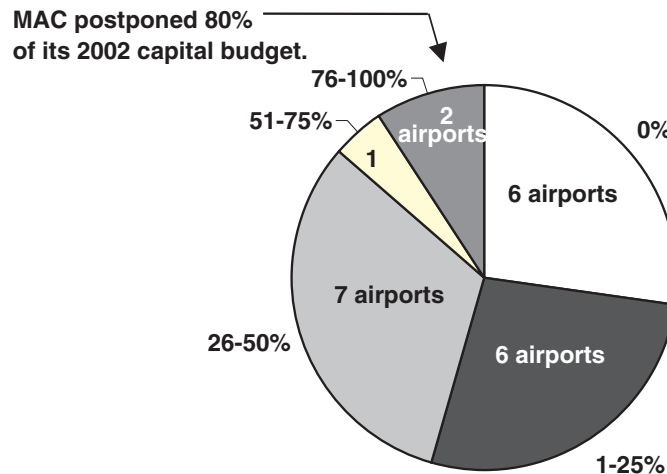
MAC cut \$118 million from projects remaining in its 2001 capital budget. It also reduced its 2002 capital budget by 80 percent. The 2002 budget was cut from the planned \$371 million to only \$76 million. MAC’s intent was to defer implementation of the projects being cut until the commission had a better sense of how the events of September 11, 2001 would affect the airline industry.

As Figure 2.4 indicates:

- **Most airports we contacted did not reduce their capital budgets as much as the Metropolitan Airports Commission did following September 11, 2001.**

Following September 11, MAC deferred more capital spending than did most other airports.

Figure 2.4: Percentage Reductions in Capital Budgets at Various U.S. Airports Following September 11, 2001



SOURCE: Office of the Legislative Auditor’s phone survey of airports, July-September 2002.

Three-fourths of the 22 airports we contacted reduced their capital budgets following September 11. Like MAC, most of the airports postponed the implementation of capital projects for a year or more, but a few also canceled some projects. These airports reported capital budget reductions ranging from 1 to 100 percent, but only one airport (Charlotte, North Carolina) reduced its capital budget by a larger percentage than did MAC. Only 3 of the 22 airports reduced their capital budgets by more than 50 percent. The median percentage reduction for the airports we contacted was 17 percent.

Management of 2010 Plan Costs

While airlines have agreed with the changes MAC made to its capital budget following September 11, 2001, some have been critical of how MAC has handled certain capital projects. In particular, Northwest Airlines officials have criticized the cost overrun on the light rail transit project at the Minneapolis-St. Paul

The estimated costs of implementing the 2010 expansion plan for MSP have grown by 3 percent since 1998.

International Airport and the costs of constructing the new Humphrey Terminal at MSP. The costs of these two projects are, however, only expected to be about 7 percent of the total costs of the 2010 plan for expanding and improving the Minneapolis-St. Paul International Airport. Before examining the criticisms about these two projects, we will consider how the current cost estimates for the entire plan differ from initial estimates.

The 2010 plan, which was approved by the 1996 Legislature, was estimated in 1998 to cost \$2.186 billion. Given the inflation expected to occur between 1998 and the years that various portions of the plan were expected to begin, the original cost estimate can be adjusted to approximately \$2.403 billion. Table 2.8 shows that construction of a new runway accounted for about 25 percent of the total costs of the 2010 plan. Other major portions of the plan include noise mitigation (20 percent), various rehabilitation and repair activities (11 percent), extension of the Green Concourse (10 percent), and expansion of the public parking and auto rental facilities (8 percent).

According to MAC staff, the estimated costs of implementing the 2010 plan have grown to \$2.469 billion, as of early September 2002. This figure represents the best estimate of the costs of the plan but is not final because projects are at various stages of development. The estimate reflects the cost of work that was already completed, current project budgets for work that was bid out but was not yet completed, and current cost estimates on projects for which construction bids have not yet been received.

The current estimate puts the costs of the 2010 plan within 3 percent of the original estimate, including inflation. MAC staff believe that the costs of the 2010 plan are coming in reasonably close to the original estimate, considering the difficulty of estimating costs. In addition, they point out that costs to be paid by the airlines serving MSP are currently about \$38 million below the original estimate. In contrast, costs to be paid from parking and other concessions revenues are running about \$104 million above the original estimate.

Table 2.8 shows that the largest cost overruns have occurred in four areas. First, the expansion of MSP's public parking and auto rental facilities cost \$42 million—or 21 percent—more than the original estimate of \$196 million. MAC staff say that a number of factors contributed to the increase in costs. Unforeseen conditions such as contaminated soils and the need to relocate more utilities than expected raised costs. In addition, the scope of the work was expanded. The transit center project became much more than a simple relocation of the bus stop, and two additional cars were added to the automated people mover built to serve the parking ramps.

Second, the cost of extending Concourse C and building new gate capacity at the Lindbergh Terminal increased by \$21 million—or 9 percent—from the original estimate of \$243 million. The purpose of this project was to build new gate capacity for Northwest Airlines and, in particular, for its regional air carrier partners that fly propeller airplanes and small jets. MAC staff attribute most of the increase to the bidding environment. They say this was a complicated project that was to be built on an accelerated schedule. Bids for the project were higher than estimated, but Northwest Airlines agreed that the project should go forward and the bids should be awarded. Additions to the project scope also contributed to

Table 2.8: Cost Changes for the 2010 Long Term Comprehensive Plan, As of September 2002

Program Area	Original Cost Estimate ^a	Share of Original Estimate	Current Cost Estimate	Percentage Change in Costs
Construction of New Runway	\$ 611,943,000	25%	\$ 582,021,802	-5%
Noise Mitigation	477,469,000	20	448,529,181	-6
Various Rehabilitation and Repair Projects ^b	253,985,000	11	268,240,869	6
Concourse C Extension ^c	242,677,000	10	263,670,762	9
Public Parking/Auto Rental Expansion	196,492,000	8	238,420,191	21
Reliever Airports	160,838,000	7	166,270,753	3
Miscellaneous Landside	145,255,000	6	154,093,237	6
Humphrey Terminal Development	81,357,000	3	96,137,281	18
Light Rail Transit	76,557,000	3	86,853,331	13
Runway Deicing/Holding Pads	61,156,000	3	62,789,079	3
Miscellaneous	<u>95,630,000</u>	<u>4</u>	<u>101,905,992</u>	7
Totals	\$2,403,359,000	100%	\$2,468,932,478	3%

^aThe original estimates were in 1998 dollars. These estimates were adjusted for inflation between 1998 and the start dates for individual projects.

^bIncludes airfield, runway, landside, and terminal projects.

^cIncludes the expansion of Concourse C (formerly the Green Concourse) and the construction of Concourses A and B.

SOURCE: Office of the Legislative Auditor's analysis of data received from the Metropolitan Airports Commission.

part of the cost increase. The original estimate was not based on fully bridged gates for the regional jets.¹⁴ MAC also added space to the Northwest Airlines World Club facilities at the airline's request.

Third, the cost of building a new Humphrey Terminal to serve Sun Country Airlines and the charter airlines increased by close to \$15 million—or 18 percent—over the original estimate of \$81 million. The cost increase was due in part to increases in the project scope. The commission added an eighth gate so that future growth in charter and other airlines could be accommodated. When Sun Country began providing scheduled air service, the commission added two more gates to ensure that the terminal's capacity was adequate to serve the charter airlines during the peak charter season. In-pavement fueling capability was also added to the project.

Finally, the MAC portion of the costs for the light rail stations and lines at MSP increased \$10 million—or about 13 percent—over the original estimate of \$77 million. This occurred because bids for the part of the light rail project that MAC was overseeing came in well over earlier estimates. Rather than redesign and rebid the project, the commission—at the recommendation of the chairman of the

¹⁴ Fully enclosed bridges allow passengers to board an airplane from the terminal without being exposed to outside weather conditions.

Large cost overruns have occurred on several MAC construction projects.

Metropolitan Council, the commissioner of the Department of Transportation, and the executive director of MAC—awarded the contract to the low bidder and increased the maximum MAC contribution from \$70 million to \$87 million.¹⁵ The airlines' share of the costs increased from about \$6.2 million to \$12.5 million. MAC staff offset the impact of the light rail cost overrun on Northwest Airlines by reducing NWA's costs on the Concourse C expansion. MAC did this by using revenues from passenger facility charges to reduce the costs billed to the airline for that project.



A number of construction projects have experienced cost overruns, but MAC staff believe the cost of the 2010 plan will be within 3 percent of the original estimate.

MAC staff believe that further cost increases for the 2010 plan are unlikely.

Despite the cost overruns on a number of the large projects that are underway or have been completed:

- **MAC staff are confident that the overall costs of the 2010 plan will remain within 3 percent of the original estimate.**

According to MAC staff, about two-thirds of the plan has been completed or is in the process of being completed. The remaining one-third of the plan consists of projects that MAC staff believe are less risky than those that have already been bid or completed. The two major remaining components of the 2010 plan are the new runway and the extension of the noise mitigation program to areas with noise levels of 60-64 DNL. Some of the work on the new runway has already been done, including property acquisition, underground utilities, roadways, bridges, and tunnels. Most of the rest of the work consists of paving and other above-ground elements for which there is less risk of a cost overrun. One large property must still be acquired, but MAC staff think that it will likely cost less than budgeted due to current market conditions.¹⁶

MAC is nearing completion of the noise mitigation program for homes within the 65 DNL noise contour. Although MAC's sound insulation program has experienced cost increases in the past, staff believe that this is unlikely to be a major problem with the extension of the program to the 60-64 DNL area. MAC has better information about the number and characteristics of the homes that will be insulated and the types of heating systems in the remaining homes. As a result, agency staff believe that the risk of cost overruns is low.

¹⁵ The original cost estimate—as well as the maximum contribution that MAC approved—was \$70 million. As a result, most observers would say the cost overrun on the MAC light rail project was \$17 million, or 24 percent, of the original estimate. We are, however, using the \$70 million from the 2010 plan, which was calculated in 1998 dollars, and adjusting it for the inflation between 1998 and the start of the project. As a result, the “original” estimate becomes about \$77 million.

¹⁶ The cost of constructing the new runway and associated work is projected to exceed the original estimate. But, the net cost of the project is currently expected to be about \$30 million less than the original estimate of \$612 million due to \$83 million in revenues from operating properties acquired by MAC. The revenues from these properties, which had to be acquired in order to operate the new runway, were not included in the original cost estimate for the project.

There is some risk of cost overruns with the remaining parts of the light rail transit project since station construction and about half of the station excavation are not completed. MAC staff say, however, the risk of cost overruns on these portions of the project are considerably less than on the tunnel excavation and the portion of the station excavation already completed.

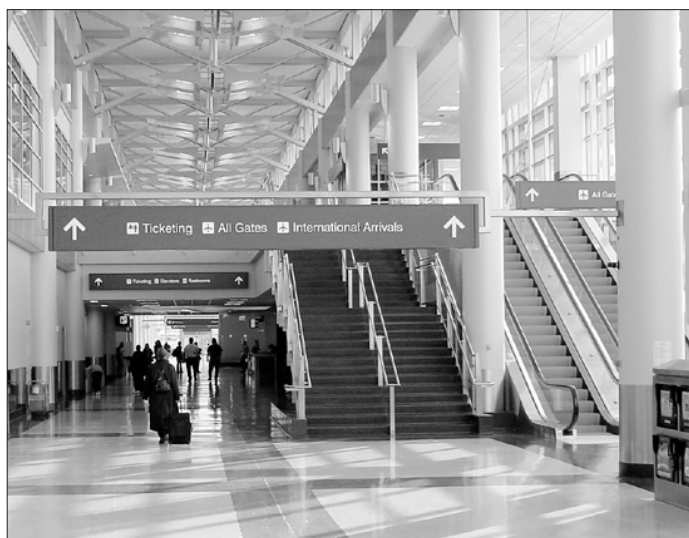
While MAC staff are confident that the actual cost of the 2010 plan will ultimately be within about 3 percent of the original estimate, it is difficult for us to reach a firm conclusion since there is at least \$700 to \$800 million in work remaining to be done. In addition, it is difficult to come to a firm conclusion about MAC's efforts to control capital costs on those projects it has completed. Sometimes, there are good reasons why project costs exceed estimates. Bids exceed estimates at times, and awarding the contract may be appropriate if MAC does not believe that the project can or should be scaled back or that the bidding environment would improve. In addition, unforeseen conditions can result in additional costs. Changes in project scope may be justified if market conditions have changed or original planning failed to consider important factors.

The new Humphrey Terminal provides capacity for future expansion but is currently underutilized and requires an operating subsidy.

The construction of the new Humphrey Terminal has been criticized because it is now underutilized and has an estimated revenue shortfall of \$2.5 million for 2002.¹⁷ MAC officials, however, defend the project as necessary in light of the overcrowding at the old Humphrey Terminal's gates and its undersized ticketing and bag claim areas. Sun Country's decision to provide scheduled air service, as well as charter service, affected the size of the project although the completion of two of the ten gates was deferred following the airline's decision to end scheduled service and file for bankruptcy protection.

When MAC made the decision to build a new Humphrey Terminal, the economy was growing and air traffic was increasing at MSP. MAC could not have foreseen the decline in travel that would occur with the economic recession and the events of September 11, 2001. But it could

be argued that MAC should have been somewhat more skeptical that Sun Country would succeed with its business plan to provide scheduled service and compete successfully over the long run. Sun Country's management had limited airline industry experience and found it very difficult to compete successfully by



The new Humphrey Terminal is currently underutilized but provides the airport with facilities to accommodate new air service in the future.

¹⁷ Faced with the much higher costs of a new Humphrey Terminal and a reduction in Sun Country air service, MAC is not able to recoup the costs of the terminal from current users. During 2002, MAC used an estimated \$2.5 million in parking and other concession revenues from the Lindbergh Terminal to subsidize the operation of the new Humphrey Terminal.

providing service of one flight per day to a large number of cities. The airline incurred significant losses even before the events of September 11 compounded its problems and caused it to file for bankruptcy protection.¹⁸

Even though the new terminal is greatly underutilized at the present time, MAC officials point out that the airport is well-positioned for the future in the event that airlines wish to provide additional service at MSP. The airport will have gates available to attract new entrants and help keep airfares competitive.

It is unlikely that MAC will be expanding gate capacity in the foreseeable future for new entrants at MSP. But this may happen at some point in the future as the aviation industry and economy recover and air travel once again grows. At that point, MAC officials should more carefully weigh the risks to MAC, as well as the costs and benefits to the traveling public, involved in expanding the number of gates at MSP.

NON-AIRLINE OPERATING REVENUES

Background

Concessions represent a substantial portion of MAC's operating revenues.

In 2001, the Metropolitan Airports Commission collected \$73 million in airline rates and charges and \$97 million in operating revenue from non-airline sources. The largest source of non-airline operating revenues is concessions, including parking, rental cars, food and beverage sales, and merchandise sales. Concession revenues were close to \$70 million in 2001. Concession revenues can help pay airport operating costs, and any amount not needed for that purpose is available for making bond payments or directly paying for capital projects.

MAC contracts out most of the concessions at MSP. MAC hires a private company (APCOA) to manage its parking facilities. In 2001, it paid about \$5.9 million for parking management services and received gross parking revenues of \$39.3 million. MAC receives bids from private rental car companies that wish to do business at MSP. Revenue in 2001 from these companies was \$13.7 million.

MAC also contracts with private companies to operate the retail, food, and beverage concessions at MSP. MAC's revenues from merchandise sales were \$4.6 million in 2001, while revenues from food and beverage sales were \$4.1 million. HMS Host, or its corporate predecessors, has operated concessions at MSP since at least the 1970s. Currently, HMS Host provides concessions in the main Lindbergh Terminal building and on Concourses D, E, and F. It also ran the concessions in the old Humphrey Terminal. Anton Airfood operates the food and beverage concessions in the new Humphrey Terminal and on Concourses A, B, and C in the Lindbergh Terminal; and PCBR operates the retail and merchandise concessions in those areas. MAC also contracts with a variety of individual concessionaires, such as hair and beauty shops and shoeshine stands. Because of the terms of the lease for Concourse G, Northwest Airlines is responsible for the operation of concessions in that part of the Lindbergh Terminal and receives

¹⁸ The company has since been sold and is still providing significant levels of charter service at the new Humphrey Terminal, but its scheduled service has been greatly reduced.

85 percent of the rent revenues from that part of the terminal. MAC receives 15 percent of the rent revenues received by Northwest from concessions on Concourse G. Northwest Airlines also contracts with HMS Host to provide a significant portion of the concessions on that concourse.

For food, beverage, and retail concessions, MAC receives a minimum negotiated rent or a specified percentage of gross sales, whichever is greater. Generally, MAC has received more than the minimum rent from HMS Host, so its revenues from Host-operated concessions depend on the amount of sales, as well as the percentage of gross sales that concessionaires are required to pay to MAC. The Anton and PCBR contracts tend to have lower rent percentages than the HMS Host contract but have high minimum rents. As a result, in 2001, the rents paid by Anton and PCBR were based on their minimum rents. On Concourse G, MAC gets 15 percent of the concession revenues received by Northwest Airlines.

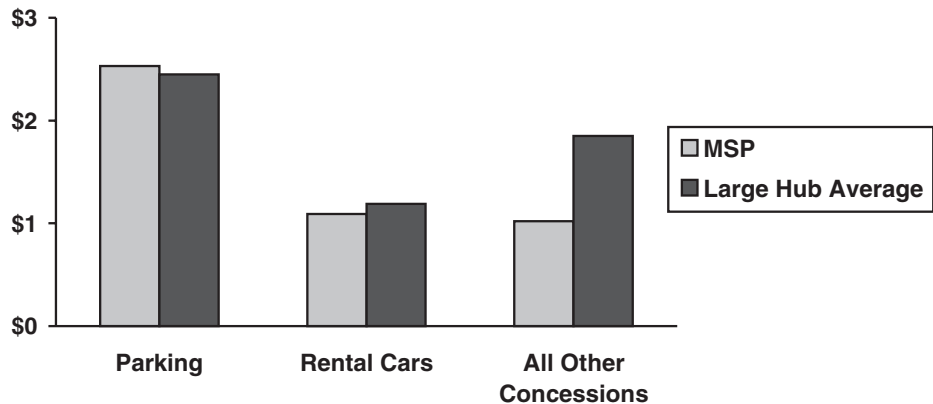
Revenue Comparisons

Figure 2.5 shows how MAC revenues from various concessions compare with revenues at other large hub airports. Parking revenues per enplaned passenger were about 3 percent higher at MSP than the average for large hub airports in 2000. In addition, rental car revenue was about 8 percent below the large hub average. However, even including the concessions revenue received by Northwest Airlines:

- Revenue per enplaned passenger from MSP concessions other than parking and rental cars was 45 percent below the average for large hub airports in 2000.

MAC's concession revenue from sources other than parking and rental cars is well below the average for large airports.

Figure 2.5: Concessions Revenue per Enplanement, MSP Compared With Other Large Hub Airports, FY 2000



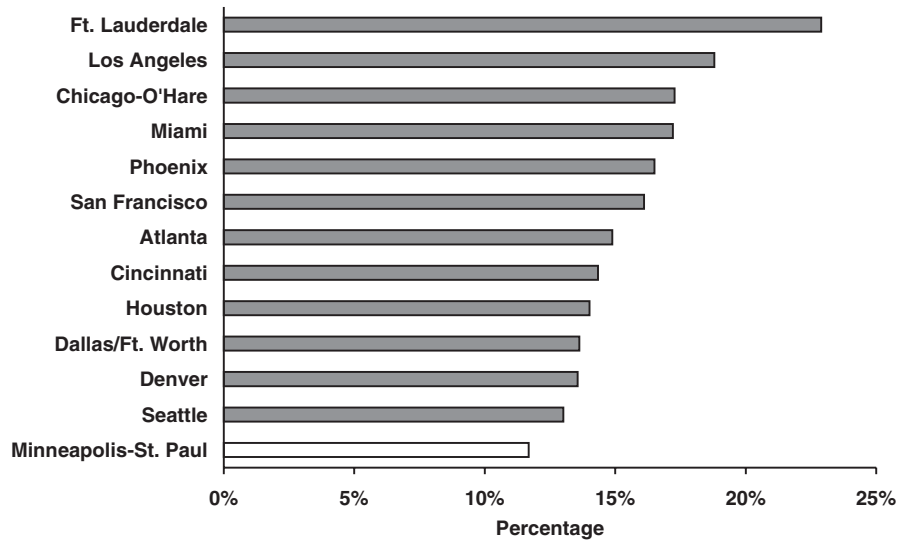
SOURCE: Office of the Legislative Auditor's analysis of data from the Federal Aviation Administration.

To understand MSP’s lower than average concession revenues, we focused on revenues from food, beverage, and retail concessions—which are a major part of the revenues MAC receives from concessions other than parking and rental cars. We asked a MAC official whether below average rents charged to concessionaires were responsible for MAC’s below average revenues. The MAC official initially assured us that rents paid by MAC’s concessionaires—as a percentage of gross sales—are consistent with general practices at other airports. But, when we asked for evidence to support his assertion, he asked a MAC consultant to provide data comparing MAC sales and rents with those at a sample of other large hub airports. Figure 2.6 provides a summary of the rent data provided by the consultant. The data show that:

- **The rent that the Metropolitan Airports Commission receives from food, beverage, and retail concessionaires is low in comparison with rents at other large hub airports.**

MAC’s rental rates for retail, food, and beverage concessionaires appear to be among the lowest in the industry.

Figure 2.6: Airport Rent Revenue as a Percentage of Gross Sales from Retail, Food, and Beverage Concessions, 2001



SOURCE: Office of the Legislative Auditor’s analysis of data from the Metropolitan Airports Commission and the Center for Airport Management, LLC.

For 2001, MAC received rent from food, beverage, and retail concessionaires of 11.7 percent of gross sales.¹⁹ This figure was more than one-fourth less than the average of 15.7 percent received at 13 large hub airports including MSP. MAC’s rent percentage was lower than the percentage at any of the other airports used for comparison purposes. The rent percentage at the other airports in the consultant’s sample ranged from 13 to 23 percent.²⁰ In addition, MAC’s rent was lower than

¹⁹ This figure does not include revenues and sales on Concourse G.

²⁰ The average rent received from food and beverage concessions was generally smaller than that received from retail concessions. MAC received an average rent of 10.3 percent from food and beverage concessions compared with a large hub average of 13.8 percent. For retail concessions, MAC received an average rent of 13.3 percent compared with a 18.4 percent average for other airports.

that received by Northwest Airlines from concessions on Concourse G. The airline's concessions revenue was 15.8 percent of gross sales during 2001.²¹

MAC's rents *per passenger* and sales *per passenger* are difficult to compare with those at other large airports. Because Northwest Airlines controls the concessions on Concourse G, it is necessary to allocate a portion of the passengers at MSP to concession sales on Concourse G and the remaining passengers to concessions under MAC's control. About 29 percent of departing passengers used Concourse G in 2001, while 71 percent departed from other concourses. It would be inaccurate, however, to assume that the passengers who departed on Concourse G only purchased concessions from the stores on Concourse G. In fact, it is likely that many of these passengers, who generally pass through MAC's concessions area first, purchased concessions from MAC-controlled concession operations. It is less likely—though possible—that passengers departing from concourses other than Concourse G purchased concessions on Concourse G.²² As a result, any comparison of sales or rents per passenger that splits the passengers at MSP based on the concourse on which they departed would probably understate the number of passengers that frequent stores under MAC's control—and thus overstate MAC's sales or rents per passenger.

Concession sales per passenger at MSP appear to be slightly above the industry average.

We compared MAC's sales per passenger with other large airports using only those passengers at MSP who departed at concourses other than Concourse G. These comparisons suggest that MAC's sales per passenger were about 14 percent above the average for the 13 large airports including MSP. This comparison, however, probably overstates the extent to which sales per passenger at MSP exceed the average, for the reasons outlined above. If all concourses and passengers at MSP are included in the comparison, we found that sales per passenger at MSP were only about 4 percent above the average in 2001 and ranked sixth highest of the 13 airports.



MAC's rent revenues from concessions are below the industry average, while sales appear to be slightly above average.

In 2001, MAC's rents per passenger were below the average for the group of large airports included in the consultant's comparison. But, the extent to which rents per passenger are below average depends on how passengers are allocated in the comparison. A simple comparison suggests that MAC's rents per passenger were

²¹ MAC's current contract with HMS Host requires Host to pay rent equal to 7.5 percent of sales of food and non-alcoholic beverages and 12 percent of sales of alcohol at "branded" stores, while Northwest Airlines' current contract with Host entitles them to 12 percent of "branded" food and beverage sales and 20 percent of alcohol sales on Concourse G. (Branded stores are well-known stores that sell brand-name products, such as Burger King.) In addition, MAC currently receives rent equal to 10.5 percent of sales of non-branded food and beverages and 15 percent of sales of alcohol at non-branded facilities. In contrast, Northwest receives 15 percent of the sales of non-branded food and beverages. On gift and newsstand sales, MAC receives 16 percent, while Northwest receives 18 percent. Northwest Airlines has also negotiated increases in their rent percentages for 2003.

²² These passengers would have to go more out of their way to make purchases on Concourse G.

about 15 percent below average and ranked eighth highest of 13 airports in 2001. If all concourses and passengers at MSP are included, however, MSP's rents per passenger were 18 percent below average and ranked ninth highest of 13 airports. Regardless of the method used, MAC's rents per passenger have been below average when compared with other large airports.

MAC staff caution that accurate comparisons of rents can be difficult to make across airports. The percentage of sales paid as rent is likely to be higher for long-term contracts.²³ In addition, a lessee would probably pay a lower rent if the lessee had to contribute substantial funds toward the remodeling or building of its retail facilities. In the latter half of the 1990s, substantial renovation of the concessions occurred at the Minneapolis-St. Paul International Airport. MAC paid \$13 million toward the remodeling of the Lindbergh Terminal. HMS Host only paid \$2 million, and a few sub-lessees to HMS Host paid to finish their store interiors.²⁴ In contrast, Anton Airfood and PCBR had to contribute more toward the building of their retail facilities. MAC gave Anton and PCBR \$100 per square foot for construction costs but required them to spend at least another \$200 per square foot.

Despite their much shorter contracts and higher construction cost contributions, Anton Airfood and PCBR paid higher rents as a percentage of their 2001 sales than did HMS Host. Anton's rent as a percentage of gross sales was 15.1 percent and PCBR's rent was 12.8 percent of sales.²⁵ In contrast, Host's rent was only 11.0 percent of its gross sales. Clearly, the HMS Host contract is a key source of MAC's lower than average rents. We are particularly concerned that MAC has had a long-term relationship with HMS Host, and its corporate predecessors, with no competitive bidding of the contract for more than 20 years.²⁶ The only time that the food and beverage portion of Host's contract was competitively bid was in the late 1970s. It appears that MAC has never competitively bid the retail, news, and gift portions of Host's contract. We recommend that:

MAC needs to increase its rental rates for certain concessions.

RECOMMENDATION

When contracts for retail, food, and beverage concessions expire at the end of 2003, the Metropolitan Airports Commission should consider increasing the percentage of gross sales paid as rent to a level more comparable with other large hub airports.

²³ Other factors affecting rents might include the demographic characteristics of airport passengers, the age of concession facilities, and the requirements placed by airports on participation by businesses owned by disadvantaged individuals. MAC staff also believe that newer contracts have generally paid more rent than older contracts.

²⁴ According to MAC officials, HMS Host should not have even incurred the \$2 million cost, but it was Host's error.

²⁵ The contracts for Anton Airfood and PCBR require them to pay rent equal to the greater of 10 percent of gross sales or \$55 per square foot per year. Although their percentage rents are not significantly different than those paid by HMS Host, their minimum rents per square foot are higher and are responsible for their higher overall rent payments in 2001.

²⁶ The current contract with HMS Host dates back to 1988. MAC staff negotiated this contract with HMS Host and did not use a competitive process to solicit bids from other concessionaires.

While MAC has won numerous national awards for its concessions program, MAC should be able to receive more revenue from concessions than it is currently receiving. Additional revenues could help relieve some of the burden on the airlines from MAC's large construction program.

Until recently, MAC staff told us they were currently considering a 14-month extension to the concessionaire contracts that expire at the end of 2003. In October 2002, HMS Host officials offered a 5-year extension of its contract with a significant increase in rent. The HMS Host offer, however, contains a number of provisions that MAC staff believe are not in line with today's competitive market.

In part due to our finding that MAC's rents are not competitive in the current market, MAC staff say they are no longer considering an extension to the HMS Host contract.²⁷ MAC staff will likely be recommending to the commission that the concessions currently controlled by HMS Host be competitively bid prior to the contract's expiration at the end of 2003. MAC staff would likely recommend future options for consideration by the commission. Options could include: 1) increasing the number of master concessionaire firms like HMS Host that are responsible for the concessions currently operated by HMS Host; 2) eliminating master concessionaires and having MAC staff deal directly with restaurants and retail firms at the airport; or 3) retaining a single master concessionaire responsible for the concessions currently under HMS Host's control.

In any event, we think the discussion about various options should focus on increasing MAC's *net return* from concessions operated at the airport. If greater numbers of MAC staff are used to manage and contract directly with restaurants and retail firms, then those staffing costs should be factored into calculations of MAC's net return. If MAC considers options that require it to make capital expenditures for new or existing firms, those costs should also be factored into net return calculations.

In considering future options for its concessions program, MAC should also give some consideration to customer prices paid for food, beverages, and retail goods at MSP. But increasing rent percentages paid by concessionaires should not



While MAC has won numerous awards for its concessions program, it needs to improve its financial returns from the program.

Discussions of future options for the concessions program should focus on the net financial return to the airport.

²⁷ MAC staff say that they are likely to recommend an extension of the contracts with Anton Airfood and PCBR for a period of slightly more than five years. Both companies have paid higher rents than HMS Host despite having much shorter contracts and less desirable locations. These companies also were asked to contribute more toward the construction of concession facilities.

necessarily mean that customer prices rise accordingly. The low rents currently paid by concessionaires at MSP may not be resulting in lower customer prices but instead higher profits for the concessionaires.

Auditing Concessionaires

The Metropolitan Airports Commission entrusts concessionaires to pay MAC in accordance with contract language. Because the rent that food, beverage, and retail concessionaires pay MAC is based on gross sales, it is important for MAC to have independent confirmation that the reported sales figures are accurate. In addition, other contract payments such as reimbursements for utilities are important to monitor. Similarly, MAC needs to confirm the accuracy of the parking revenues reported by the parking management firm with which it contracts.

A MAC internal audit found significant billing problems in the concessions program.

MAC has two internal audit staff responsible for auditing concessionaires at MSP and firms that provide various services at its reliever airports. We think that such internal audits are important ways that MAC can ensure that it is receiving the amounts of revenue to which it is entitled. For example, a recent MAC audit of HMS Host found significant billing problems.²⁸ MAC never billed HMS Host for most of the utility costs that the company was required to pay. The audit found that Host was responsible for about \$530,000 in utility costs during the four-year audit period, 1998-2001. In addition, Host is paying MAC about \$1 million for unpaid utilities from 1986 through 1997.

MAC staff have implemented changes to address the billing problems with HMS Host. For example, MAC staff are reviewing existing contracts to ensure that contractors are appropriately billed. In addition, staff from MAC's finance and commercial management departments have established procedures to ensure that billings will be accurate for any new contractors.

These internal audits of contractors, however, are completed at infrequent intervals. Between audits, MAC staff may rely on audited financial statements or independent certifications of sales provided by large contractors. A recent financial audit of MAC by our office pointed out that MAC does not have a formal policy specifying when these forms of greater financial assurances are required.²⁹ MAC needs to develop such a policy. In addition, MAC may wish to use its internal audit staff to perform spot checks of sales figures of certain concessionaires, or parking receipts and management costs, between audits.

²⁸ MAC internal audit staff are currently completing an audit of APCOA, which provides parking management services at MSP. The results of that audit are not yet available.

²⁹ Office of the Legislative Auditor, *Metropolitan Airports Commission, Financial-Related Audit, January 1, 1999, through December 31, 2001* (St. Paul, November 2002), 7-8.