Evaluation Report Summary #03-04a

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Metropolitan Airports Commission

January 2003

Major Findings:

- The Metropolitan Airports Commission (MAC) operates with considerable autonomy and limited oversight by state officials.

The Metropolitan Airports Commission (MAC) is generally well regarded, but it should be subject to more state oversight.

- Nevertheless, MAC's administration of the Minneapolis-St. Paul Airport (MSP) is generally well regarded, and the airport's operating costs are relatively low compared with other U.S. airports.
- MAC has shown more fiscal restraint than most airports in recent years, but the 12 percent increase proposed by MAC staff for 2003 was insensitive to the airline industry's financial distress and not adequately justified in presentations to the commission. The commission ultimately adopted a 6 percent increase and kept airline charges from increasing by using revenues from 2002.
- MAC receives lower rents from food, beverage, and retail concessionaires than do most other large airports.
- The noise mitigation program for MSP is one of the largest in the nation, and it is generally consistent with broad policies set forth by MAC and the Legislature in the mid-1990s.
- Eligibility for MAC's sound insulation program is based on airport noise projections for 1996 that proved to be inaccurate. Some homes did not qualify for insulation although they experienced noise levels in 1996 that exceeded the threshold used to determine eligibility. In general, however, noise levels have declined since the mid-1990s.

Key Recommendations:

- The Legislature should (1) require Senate confirmation of MAC commissioners, (2) specify commissioners' terms in law and clarify the Governor's authority to replace commissioners, (3) periodically hold hearings to discuss MAC's budget, performance, and policies, (4) require MAC to issue a preliminary budget 90 days prior to MAC's budget approval, and (5) consider expanding the list of MAC capital projects that, by law, must be approved by the Metropolitan Council.
- MAC should (1) extend the time for public consideration of its initial budget targets, (2) improve the availability of public information regarding its policies and meetings, and (3) consider increasing the percentage of gross sales paid as rent by food, beverage, and retail concessionaires.

Report Summary

The Legislature established the Metropolitan Airports Commission (MAC) in 1943 to plan and operate airports in the Twin Cities region. MAC's principal responsibility is management of Minneapolis-St. Paul International Airport, which has the seventh largest number of "operations" (arrivals and departures) among U.S. airports. MAC also operates six "reliever" airports in the region.

Airport Operating Costs Are Low; Concession Revenues Could Be Higher

MAC's annual operating revenues totaled about $170 million in 2001. MAC's revenues come primarily from (1) rates and charges paid by airlines, and (2) concessions (parking, rental cars, and food, beverage, and retail outlets). MAC receives no state appropriation, and it currently levies no property taxes (although it has authority to do so).

MAC exercised fiscal restraint following the September 2001 terrorist attacks, but the staff's proposed 2003 budget increase was not justified.

The rates and charges paid by airlines using the Minneapolis-St. Paul Airport have been relatively low. In 2000, the airlines' costs per "enplaned passenger" were 12 percent lower at the Minneapolis-St. Paul Airport than the median for "large hub" U.S. airports.[1] Likewise, the airport's overall operating costs per enplaned passenger were 37 percent below the median cost for large hub U.S. airports. Between 1990 and 2001, inflation-adjusted operating costs per enplaned passenger increased 3 percent at Minneapolis-St Paul Airport.

Following the September 11, 2001 terrorist attacks, MAC reduced its operating expenses more than most airports. MAC's 2002 budget was 6 percent lower than its actual 2001 spending. Only 2 of 20 airports we contacted (Jacksonville and Los Angeles) reduced their operating budgets by a larger percentage than did MAC; half of the airports actually increased their operating budgets.

MAC staff initially proposed a 12 percent budget increase for 2003. While airport rates and charges have a relatively small impact on airlines' financial viability, staff provided insufficient justification for the increase, and the proposal seemed out of step with the distress occurring in the airline industry. Ultimately, the commission reduced the increase to less than 6 percent and used 2002 operating income to keep airline charges from increasing.

Following the September 11 attacks, MAC reduced its 2002 capital budget by 80 percent, mostly through short-term deferrals of projects. This was a larger reduction than that of most other major U.S. airports. Still, MAC is proceeding with a legislatively-authorized capital plan, projected to cost $2.5 billion before its completion in 2010. MAC presently estimates that the plan will cost 3 percent more than original estimates, but about one-third of the work has not yet been bid out.

MAC's revenues from retail, food, and beverage concessions totaled $8.6 million in 2001. On average, the rental rates charged to concessionaires at the Minneapolis-St. Paul Airport are about one-fourth lower than those charged at other large airports. Various food, beverage, and retail contracts will expire at the end of 2003, and MAC should use this opportunity to consider increases in the percentage of gross sales paid as rent.

Minnesota-based Northwest Airlines leases 81 percent of the gates at Minneapolis-St. Paul Airport and has a significant impact on the state's economy. If not for federal assistance, Northwest's operating losses in 2001 would have been larger than those experienced in 1992, when the company was close to bankruptcy. Federal regulations restrict

1 A "large hub" is an airport that accounts for at least 1 percent of the nation's total enplaned passengers on U.S. air carriers. "Enplaned passengers" are all paying passengers who board aircraft; a passenger who changes planes once during a trip would have two enplanements for that trip.

MAC's proposed expansion of its residential sound insulation program would be more ambitious than the programs of other airports.

MAC's ability to assist individual airlines. But MAC has provided general relief to airlines by deferring charges for certain capital costs, and it assisted Northwest Airlines in 2002 by refinancing bonds issued on Northwest's behalf in the early 1990s. Meanwhile, MAC has taken steps to encourage competition at the Minneapolis-St. Paul Airport, but factors beyond MAC's control have limited the success of these efforts.

MAC's Noise Program Is Extensive, But Eligibility Has Been Based on Outdated Projections

To mitigate the impact of airport noise, MAC has insulated about 7,000 homes near the Minneapolis-St. Paul Airport. This is one of the most extensive sound insulation programs among U.S. airports. So far, this program has been financed with passenger surcharges and federal funds.

When the Legislature decided in 1996 not to build a new airport, it required MAC to spend at least $185 million on noise mitigation from 1996 through 2002. MAC exceeded this requirement, having spent about $210 million since 1996 (and nearly $300 million since the program began).[2]

Eligibility for MAC's sound insulation program has depended on projections MAC did more than a decade ago. Homes have qualified for sound insulation if MAC projected in 1992 that their 1996 noise levels would be 65 DNL or greater. "DNL," or "day-night level," is a measure of noise based on 24-hour averages. However, MAC's projections for 1996 underestimated the airport's total number of flights, overestimated the use of quieter ("Stage 3") planes, and assumed that a much larger proportion of flights would depart and arrive over the Bloomington and south Richfield area than was actually the case. Consequently, certain areas in south Minneapolis, north Richfield, Mendota Heights, and Eagan experienced noise in excess of 65 DNL, even though MAC had projected noise in these areas of less than 65 DNL.

These higher-than-expected noise levels did not result, however, in more homes becoming eligible for sound insulation. MAC determines eligibility for sound insulation using noise exposure maps for *projected*, not *actual*, noise levels—consistent with regulations that govern the federal noise mitigation program from which MAC receives substantial funding. MAC did not revise its noise projections in the mid-1990s because the Legislature was in the midst of determining the airport's future. Moreover, even if MAC had updated its five-year projections in the mid-1990s, program eligibility might not have expanded—because MAC would have had to factor in the effect of quieter planes that federal law required by 2000.

There has been controversy regarding MAC's commitment to expand the sound insulation program after completing work on homes with noise above 65 DNL. Some local officials thought that MAC promised in 1996 to implement an expanded program identical to the existing program, but MAC's written commitments were not specific. In 2002, MAC reconsidered the issue and decided to provide *varying* levels of mitigation for homes with projected noise levels between 60 and 64 DNL. Still, MAC's noise mitigation policy for homes with noise levels below 65 DNL is more ambitious than that of other airports and commits to a spending level consistent with a 1999 operating agreement between MAC and the airlines.

MAC Needs More State-Level Oversight

The Metropolitan Airports Commission consists of 15 appointed members, and its decisions do not require approval by elected officials. The Governor appoints 13 of the commissioners (not subject to legislative confirmation), and in recent years the Governor has had little contact

2 Includes the cost of residential and school insulation, as well as property acquisition.

with MAC beyond initial appointments. The Legislature had extensive discussions in the mid-1990s leading to a decision to keep the airport at its present location, but since then it has engaged in limited oversight of MAC's policies, budget, and performance.

The Governor's appointees to MAC should be subject to Senate confirmation.

MAC's actions have statewide impact and should receive frequent attention from state officials. MAC's decisions affect travelers, Minnesota-based airlines, and communities near Twin Cities airports. In addition, MAC makes large-scale capital budget decisions and operates one of Minnesota's most visible public facilities. Although airline officials generally think that MAC runs Minneapolis-St. Paul Airport effectively, they have sometimes questioned MAC's responsiveness to their concerns.

The Legislature should play a larger role in overseeing MAC—through periodic hearings and Senate confirmation of appointees. MAC does not receive a state appropriation, so the Legislature should not formally approve MAC's budget. But MAC should provide more time for legislative and public input into its proposed budgets, and it should improve public access to information regarding its meetings and policies. If necessary, the Legislature should provide direction in law regarding MAC's policy and budget priorities.

The 2002 Legislature discussed—but did not pass—major changes in MAC's governance structure, including proposals to make MAC a state agency. Nationally, states operate only 2 of the 40 largest airports. Changing MAC to a state agency would significantly disrupt an agency that has received generally good marks for its day-to-day airport management, and there is little support among Minnesota-based airlines for such a change. It would be preferable for the Legislature and Governor to improve state-level oversight of MAC, without making structural changes at this time.

In addition, the Legislature should clarify the terms of MAC commissioners and the Governor's authority to remove commissioners. Currently, the terms of eight members appointed by the Governor are not specified in law. In contrast, there are explicit statutory provisions for the other commissioners appointed by the Governor—specifically, the chair serves at the pleasure of the Governor, while four commissioners serve four-year terms.

The full evaluation report, *Metropolitan Airports Commission* (#pe03-04), includes the agency's response and is available at 651-296-4708 or:

www.auditor.leg.state.mn.us/ped/2003/pe0304.htm

Summary of Agency Response:

In a January 14, 2003 letter, MAC Executive Director Jeffrey Hamiel said that the evaluation was "thorough" and "objective." Regarding the report's recommendations, he said that MAC will: allow more time for public consideration of staff's proposed budget targets; provide more detailed explanations of future proposals for spending increases; improve the MAC web site's information on public meetings and commission policies; seek increased concession revenues; and work with the Governor and Legislature on issues of governance and oversight.

Regarding the concerns raised in the report about MAC staff's initial 2003 budget proposal, Mr. Hamiel said: "We believe that the initial proposal was justified considering budgetary reductions in 2002 and the significant expansion of [Minneapolis-St. Paul International Airport] facilities." He agreed with the report's conclusion that staff should have provided better explanations of the cost impacts of the expansion.