TO: HONORABLE CITY COUNCIL

FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES

DATE: JUNE 2, 2008 CMR: 247: 08

SUBJECT: PROGRESS REPORT ON NEGOTIATIONS WITH SANTA CLARA COUNTY AND OTHER STEPS TO FACILITATE CITY OVERSIGHT OF THE PALO ALTO AIRPORT

This is an informational report and no Council action is required.

BACKGROUND
The 50-year lease between the City and the County of Santa Clara for the Palo Alto Airport (PAO) terminates in 2017. On December 12, 2006, County staff presented to the County Board of Supervisors a business plan (Plan) for PAO, including an analysis of the lease; an overview of the County Airport Enterprise Fund; an analysis of PAO’s finances; identification of future capital investment needs; and recommended County action in anticipation of the lease expiration in 2017.

The Plan noted that the County has assumed all of the business risk associated with operating PAO; that PAO has historically operated at a deficit; and that opportunities to generate additional revenue were extremely limited due to physical, environmental, and policy constraints. The Plan recommended that the County:

1) Terminate its involvement in PAO in 2017 or earlier if desired by the City,
2) Limit future County capital investment in PAO to the local matching funds necessary for essential, non-deferrable, Airport Improvement Project (AIP)-eligible maintenance projects or security related projects mandated by Federal agencies;
3) Require the City to submit all future AIP grant applications; and
4) Raise tie-down rates and fuel flowage fees to help make PAO financially self-sustaining and recover as much of the County’s original investment in PAO (Outstanding Advance) as possible prior to the lease expiration.

The County Board of Supervisors approved the Plan, but delayed action on the disposition of PAO for six months in order to provide the City an opportunity to present the County with viable development options for PAO and time to negotiate those options.

On December 18, 2006, Council authorized the creation of the Palo Alto Working Group (PAAWG) to analyze PAO operations and develop one or more viable business models for
PAO. The PAAWG included representatives from the City Council, City staff, the Palo Alto Airport Association, Stanford Hospital, the Joint Community Relations Committee for the Palo Alto Airport and representatives of stakeholder groups with an interest in PAO use and operations. On June 4, 2007, the PAAWG presented its report to the City Council.

Principal findings from the PAAWG report included:
1) that airport operations were profitable;
2) that, based on PAAWG’s own financial analysis and the City Auditor’s review, the PAO has the economic potential to be self-sustaining, fund necessary improvements, and cover the cost of City administrative overhead;
3) that the airport was an essential community asset; and
4) that the County ignored numerous economic and social benefits the airport provided. These benefits included: tax revenues generated by the airport that support local jurisdictions; transportation for businesses and their employees; transport for hospital patients and transplant organs; pilot training and certification; recreation space for the local community; emergency support activities; and PAO’s part in the Bay Area airport and transportation system.

The PAAWG concluded:
- PAO is an important transportation, business, economic, recreational and emergency preparedness asset for the City and its residents;
- PAO can be operated on a self-sustaining, economical basis and be cash positive without requiring any financial support from the City; and
- The continued operation of PAO by the County will both diminish the resource value of the airport and threaten its long-term economic viability.

These conclusions led the PAAWG to recommend that the City Council:
1) Direct the City Manager to negotiate an early termination of the existing PAO lease with the County;
2) Appoint an interim manager for PAO; and
3) Issue an RFP for the long-term management of PAO, which will ensure its asset value to the community is maintained and will preserve its economic value into the future.

On September 18, 2007 (CMR 361:07), the Finance Committee discussed staff’s response to the PAAWG recommendations and three options related to the future of PAO: 1) do nothing and wait until the lease expires in 2017; 2) assume responsibility for PAO immediately; or 3) plan for an orderly transition to City oversight and take a more active, immediate role in PAO operation. The Committee split on the recommendation and agreed to forward the report to the full Council for its review along with staff’s response to a list of questions to be researched. On November 13, 2007 (CMR 418:07), Council directed staff to begin negotiations with the County on an early termination of the lease and to commence work on the items set forth in the November 13, 2007 staff report. Council also directed staff to provide progress reports to the City Council every six months beginning in May 2008.
DISCUSSION
As directed by Council on November 13, 2007, this is the first biannual progress report. Included in this first report is an update on staff’s progress towards completing PAO action items as well as other information updates. The action items are a combination of two lists of progressive steps taken from prior staff reports (Attached C – CMR 418:07 and 361:07)

Progress on Steps

1. City/County negotiations regarding the “outstanding advance”
The outstanding advance is the difference between the County’s total capital investment, including grant matching fees, and the net revenue generated over the term of the PAO lease. The offer by the Director of the Santa Clara County Roads and Airports Department to waive any remaining “outstanding advance” when the City takes over PAO will require the approval of the County Board of Supervisors. This offer has been made during the course of several public meetings including during a presentation to the County Airports Commission. The outstanding advance as of June 30, 2007 was $773,408. In a City Auditor’s report to the Council on June 6, 2006, the auditor disputed the County’s claim that PAO was losing money and needed to increase fees to recoup the outstanding advance. The audit claimed PAO was paying for more than its fair share of overhead cost and questioned historic costs that were paid by a County General Fund loan. In fact, the auditor felt that it was a grant not a loan since it was not documented or paid back to the General Fund. The audit leads to the possible conclusion that if pooled overhead cost had been proportioned correctly and historic costs had been properly attributed to the County General Fund and not the airport, there would not be an outstanding advance. It is staff’s position that the airport and the City do not have a legal obligation to repay the advance unless a written agreement or contract can be produced by the County.

2. Federal Aviation Administration (FAA) Grant Proposal Review
FAA grant funding is based on a five-year airport improvement plan (AIP). Eligible projects include those improvements related to enhancing airport safety, capacity, security, and environmental concerns. AIP funds are not eligible for terminal buildings and non-aviation development. Each year, the airport manager submits a five-year airport improvement plan to the local branch of the FAA. The County AIP projects, their costs, and the year for which FAA grant funds are requested for PAO are, as follows, for the next five years:

<table>
<thead>
<tr>
<th>PROJECT</th>
<th>COST</th>
<th>YEAR</th>
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<tbody>
<tr>
<td>1) Signage, Runway/Taxiway Marking Changes IAW FAA RSAT Recommendations</td>
<td>$150,000</td>
<td>2009</td>
</tr>
<tr>
<td>2) Purchase FOD Sweeper and Portable Runway Closure Lighting</td>
<td>$60,000</td>
<td>2009</td>
</tr>
</tbody>
</table>
3) Reconfigure Taxiways G and Z to comply with FAA Standards  $400,000  2010

4) Construct Helicopter Landing Pad and Parking  $250,000  2010

5) Construct Exit Taxiway D  $120,000  2010

6) Pavement Maintenance for Existing Runway, Taxiways and Aircraft parking  $300,000  2011

7) Overlay Existing Runway and Taxiways  $2,000,000  2012

Ideally, the FAA funds 95% of the cost, the State funds 2.5% and the local match is 2.5%. Based on this calculation, the local match for the next five years of projects would be $82,000.

Federal and State funds are never guaranteed, however. An example is the last major paving overlay project completed by the County in 2000. The local match was initially estimated to be $50,000 but by the time the project was completed the County local match was $620,000. The County gave staff three reasons for the cost over-run: 1) bids were higher than the estimate; 2) the lack of State funding available at the time the project was ready to be funded; and 3) the unanticipated time and cost to obtain permit approval from the City. These costs added $479,929 to the County’s outstanding advance in the 1999-2000 fiscal year report.

Federal Funding for 2008-09 Airport Improvement Grants has not been authorized by Congress and it has been suggested that due to budget constraints Congress will reduce the grant match from 95% to 90% of the project cost.

A major concern in taking back PAO is that it does not become a burden on the City’s General Fund. The County claims that PAO is losing money, and without additional hangars, there is no opportunity to generate more income. The 2007 PAAWG Report included a Projected Pro-Forma Income Statement for 2007. When the PAAWG Income Statement is compared to the County annual report for fiscal year 2006-07 (Exhibit B), it shows approximately the same amount of net revenue ($42,100) but the PAAWG report includes a $100,000 Maintenance Reserve. The County applied the $43,533 net revenue to the outstanding advance leaving no funding for the projected AIP, FAA grant matching funds.

There are many variables in the grant process and a business plan would help the City better understand the associated risks.

Staff is preparing a scope of services for the contractor providing the business plan response that would include the following:
• Determine the long-range (20 year) financial strength of PAO  
• How to maximize current income potential and the income potential beginning in 2017 when the current contracts expire.  
• The time required to amortize the cost of constructing new hangars  
• Future viability of airports and aviation in general  
• Identify the airport’s future capital investment needs

Staff anticipates that the business plan will be available for the next 6 month update in November, 2008.

3. Current agreement and grant review
Staff has reviewed the current Fixed Base Operator (FBO) agreements and compared them to more contemporary agreements. In today’s environment, airport managers negotiate leases based on the capital the lessee is willing to invest in the airport. Lessee’s who simply rent space, with little or no capital investment, have shorter term leases than those who risk a capital investment. The two current FBO leases at PAO are long-term, and have no incentives for capital investment. The leases do not include CPI, adjustments and do not remit a percent of gross revenue with the exception of the north half of Roy Areo’s lease where the County receives 6% of the hangar rental. These leases, which are in effect until 2017, favor the FBO and do not adequately serve the revenue/growth needs of the airport. Current FAA grants will be reviewed by staff from the Public Works Department and the City Attorney’s office. However, due to workload issues, neither department has undertaken the review process to date.

4. Airport comparisons
Staff is in the process of collecting data from several airports on operations, management, the number of tie-downs, hangars and based aircraft, runway length, type of airport, and other pertinent information in order to assess the most viable management arrangement for PAO. Data so far indicates that most California municipal airports are operated by the respective city public works departments as an enterprise fund. However, City operation and management may not be the best solution for PAO. Staff has been cautioned that no two airports are alike and that to determine the best management for PAO, its unique features must be considered. Given that PAO is going to need an infusion of funds from the beginning to either provide for matching grant funds, or to provide funding for non-grant applicable projects, staff is considering a third party operator for the airport. A third party would be required to have access to revenue to meet matching funds for federal and state grants, or to make improvements in the situation where grant funding is not available. The downside of having a third party manage the airport is that the City would lose direct control. Staff research has also revealed that there are several different types of third party management, which will be described and discussed in future reports. It is also clear that someone within the City will have to oversee the third party manager and prepare the grant requests. In the next few months, staff will concentrate on finding out more information on airports operated by third parties.

It is important to note that City responsibility cannot be reassigned. As a sponsor, the City is ultimately responsible for airport operations regardless of who manages PAO.
5. Staffing needs assessment
Currently, PAO on-site staffing consists of two full-time airport operations workers and a part-time supervisor. Future staffing needs may change based on PAO’s hours of operation. In addition, regardless of whether the City assumes management of PAO or if it is run by a third party, there will always be a need for City staff to write grants and manage/monitor airport operations. The FAA is clear that, as an “airport sponsor,” the City will have full liability for operations regardless of who oversees management operations.

6. USGS topographical maps and global warming
The San Francisco Bay Conservation and Development Commission (BCDC) has produced a map using USGS information that depicts a potential global warming inundation scenario. In 2100, the water level in San Francisco Bay would rise by one meter should current trends continue. If this were to happen, all the land within the Palo Alto city limits east of 101, with the exception of portions of Bixby Park, would be underwater. This would include all of the airport, golf course, water treatment plant and the businesses along Embarcadero Road. The Army Corp of Engineers and the Santa Clara Valley Water District are taking this information into account as part of their levee analysis due in 2010. The actual USGS topographical map is anticipated to be completed in September of this year.

7. Comprehensive economic study & hazardous materials analysis
Staff is proposing to have outside contractors prepare a Comprehensive Economic Study (CES) and a Hazardous Materials Analysis (HMA). The CES will include an analysis to determine the long-term viability of PAO, providing assurance that sufficient funds can be generated to offset annual expenses and capital work. The combined estimated cost of both the CES and HMA is about $50,000, which is being proposed in the Fiscal Year 2008-09 ASD budget.

8. Metropolitan Transportation Commission general aviation review
The MTC has been holding meetings to see if there is some way the “on-time” performances can be improved at all three International Bay Area airports. One thought is to remove or reduce the non-commercial traffic from the three airports. This would have little effect on PAO, because its runway is too short to accept jet traffic, and there is very little space to accept additional aircraft. It may, however, help focus on opening Moffett Field to general aviation. Staff will continue to monitor these meetings and discussions for potential impacts on PAO.

9. US Army Corp. of Engineers levee report
In an effort to expedite the levee report, the Santa Clara Valley Water District announced recently that they will contribute $3.5 million to the study. The announcement claimed the Army Corp of Engineers money was due to run out in July of 2008. The report is currently scheduled to be completed in 2010, and it will respond to the USGS 2100 global warming prediction.
10. Review of County Financial Statements
The City Auditor’s June 2006 report on the Airport’s financial condition was discussed in the September 18, 2007 staff report (CMR 361:07). Staff recommends that a periodic review of PAO financials should be an on-going activity. Therefore, the Comprehensive Economic Study discussed above will include an update on the projected PAO financial position.

11. Council consideration and development of the Airport mission statement
The Palo Alto Airport Joint Community Relations Committee is assisting staff in drafting a proposed mission statement to be considered by the Council. Staff anticipates that the Mission Statement draft will be available for Council review and approval in the November 2008 Airport update.

12. Outline of City obligations and responsibilities for PAO
An outline of City obligations and responsibilities for PAO, whether it operates PAO or contracts out, the management, will be done as part of the Comprehensive Economic Study referred to above.

Information Updates

In addition to the 12 action item updates above, there are three information updates:

1. Transition Timing
Previous staff reports estimated that the transition of PAO from County to City oversight could occur in approximately 3 years; however, this time-line now appears too short. As staff comes to understand more about the parameters of PAO project, the scope increases in size and complexity. In addition, the PAO project and its various components must be integrated into an already heavy staff workload.

2. Tie-Down fee increase
The County will increase tie-down fees by 8% per month on July 1, 2008, which would increase the cost of the average plane at PAO to $150 per month. There are currently 361 tie-down spaces with 30 vacancies. Staff is concerned that if the County continues to raise the tie-down fee, pilots will seek other local airports, which; in turn, will decrease PAO’s revenue stream. The County claims only one pilot has stated he was moving due to the upcoming fee increase, that the vacancy rate is similar to the other two County airports and is not unusual given the current economy. In July, the tie-down rates for Reid Hillview will be increased to $140 per month and for South County to $100 per month for the same type of aircraft used in PAO quote above. San Carlos does not have any tie down vacancy at the moment due to a hangar construction project but their tie down rate is only $115 per month and they are only 10 miles from PAO. Additionally, West Valley Flying club is a tenant of both airports and they currently have 25 planes in the County tie-down area of PAO. West Valley has indicated that they would move their planes from PAO if the rates continue to increase.
3. County reasons for terminating the lease
In the first monthly meeting in January between City and County staff, the County outlined the following three main reasons for terminating its lease for PAO:

A. Inability to generate additional revenue to keep up with expenses.
PAO generates its income from 3 main sources of revenue: fuel fees, tie-downs and Fixed Base Operator (FBO) rentals. These sources are limited by the amount of fuel pumped, the number of tie down spaces available and terms of the FBO lease agreements. PAO is the only airport not generating revenue from public agency-provided hangars. At all other Bay Area airports, hangar rentals are another major source of revenue. It is the County’s position that constructing hangars is not feasible because there is insufficient time remaining on its lease to amortize the cost of construction. The County also contends that the City would not approve construction of hangars because of the potential conflict with the City’s Baylands Master Plan which does not anticipate expansion of the airport.

As an FAA designated “Reliever Airport,” PAO is eligible for FAA grant each year in an amount of $150,000. However, the use of the funds is limited, and must be thoroughly justified as not being diverted from basic airport payment maintenance needs. These FAA grant funds also require local matching funds. (A “Reliever Airport” is a high capacity general aviation airport in a major metropolitan area which provides pilots with an attractive alternative to using congested commercial service airports.)

B. FEMA flood control requirements.

The County’s position is that the Federal Emergency Management Agency (FEMA) will require all the buildings at PAO to be elevated to eight feet above sea-level, cresting significant cost implications. The majority of the airport is currently at about four feet above sea-level. Staff’s investigation has determined that only new buildings occupied by personnel would have to be elevated. Existing buildings and new hangars would not require elevation.

C. Strong likelihood that Moffett Field may open to relieve the three major Bay Area airports.

The San Francisco Bay Conservation and Development Commission (BCDC) is looking at ways to relieve the Bay Area’s 3 international airports from congestion. One option being considered is to move all non-commercial carrier airplanes to the various reliever airports. BCDC may look to Moffett Field as a reliever airport because, unlike PAO, it can accommodate a much greater level of traffic, or number of aircraft operations, including jet aircraft. However, a number of people in the industry feel any proposed additional use of Moffett Field is a long way off. Also, staff has been assured by the State Division of Aeronautics that even if Moffett Field were to reopen, the State and the FAA would prefer that PAO remain open as a Reliever Airport.
**RESOURCE IMPACT**  
The resource impacts of the transition of PAO operations and management from the County to the City will be considered as part of the Comprehensive Economic Study (CES) discussed above. The estimated cost ($50,000) of the CES and the Hazardous Materials Analysis will be considered by Council during the Fiscal Year 2008-09 budget process.

**POLICY IMPLICATIONS**  
This progress report is consistent with previous Council direction.

**ENVIRONMENTAL REVIEW**  
An environmental impact assessment (EIA) may be required by the California Environmental Quality Act (CEQA) and will be performed in connection with future Council decisions regarding PAO.

**ATTACHMENTS**  
Attachment A: Progress Report Items  
Attachment B: PAO Revenue and Expense Comparison  
Attachment C: CMR 418:07 and 361:07

PREPARED BY: ____________________________________________  
WILLIAM W. FELLMAN  
Manager, Real Property

DEPARTMENT HEAD APPROVAL: ____________________________________________  
LALO PEREZ  
Director, Administrative Services

CITY MANAGER APPROVAL: ____________________________________________  
STEVE EMSLIE and KELLY MORARIU  
Deputy City Managers

cc: County of Santa Clara  
    JCRC  
    Chair of the PAAWG
ATTACHMENT A

PROGRESS REPORT ITEMS

*From November 13, 2007 staff report (CMR 418:07):*

1. City/County Negotiations
2. FAA Grant Proposal Review
3. Current Agreement and Grant Reviews
4. Airport Comparisons
5. Staffing Needs Assessment
6. USGS Topographical Maps
7. Comprehensive Economic Study
8. Metropolitan Transportation commission General Aviation Review
9. U.S. Army Corp. of Engineers Levee Report
10. Review of County Financial Statements

*From September 18, 2007 staff report (CMR 361:07):*

11. Council consideration and development of the airport’s mission.
12. An outline of all City obligations and responsibilities for PAO whether it operates the PAO or contracts it out.
**ATTACHMENT B**

**PAO REVENUE AND EXPENSE COMPARISON**

<table>
<thead>
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<tr>
<td><strong>Projected Income</strong></td>
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<td><strong>Actual Revenue</strong></td>
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<tr>
<td>&amp; Expense Statement</td>
<td></td>
<td>&amp; Expense Statement</td>
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<tr>
<td><strong>Revenue</strong></td>
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<tr>
<td>Lease Revenue</td>
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<td>Aircraft Tie Down</td>
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<td>Fuel Flowage</td>
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<td>$  82,000</td>
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<tr>
<td>Transient &amp; Other</td>
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<td><strong>Total Revenue</strong></td>
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<td><strong>Operating Expenses</strong></td>
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<td>Salaries &amp; Benefits</td>
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<td>General &amp; Admin.</td>
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<td>Depreciation</td>
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<td>Levee Maintenance</td>
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<td>Contract Services</td>
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<td><strong>Total Expenses</strong></td>
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<td><strong>Net Gain or Loss</strong></td>
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<td><strong>Non-Operating Revenue Expense</strong></td>
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<td>Master Plan Development</td>
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<td>Airport Calif. Monitoring Group</td>
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<td>State Water Permit Fee</td>
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<td><strong>Total Non-Operating Expenses</strong></td>
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<td><strong>Net Income before Adjustment</strong></td>
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<td><strong>Add Back Depreciation on Capital Improvements</strong></td>
<td>$214,001*</td>
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<tr>
<td><strong>Net Income</strong></td>
<td>$  43,533</td>
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* The $214,001 is highlighted to show the County depreciates Grant Funding. It does not affect the calculation but it can mischaracterize the Airport’s current cash flow position.