Office of Inspector General
Audit Report

MORE RIGOROUS OVERSIGHT IS NEEDED TO ENSURE VENICE MUNICIPAL AIRPORT LAND SALES AND LEASES ARE USED APPROPRIATELY

Federal Aviation Administration

Report Number: AV-2011-180
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Memorandum

U.S. Department of Transportation

Office of the Secretary of Transportation

Office of Inspector General

Subject: ACTION: More Rigorous Oversight Is Needed To Ensure Venice Municipal Airport Land Sales and Leases Are Used Appropriately
Federal Aviation Administration
Report Number AV-2011-180

Date: September 29, 2011

From: Jeffrey B. Guzzetti
Assistant Inspector General
for Aviation and Special Program Audits

Reply to Attn. of: JA-10

To: Federal Aviation Administrator

In fiscal year 2010, the Federal Aviation Administration (FAA) provided airports nationwide over $3.4 billion in Airport Improvement Program (AIP) funding. As required by Federal law, recipients of AIP funds must ensure that airports are as self-sustaining as possible and use airport revenues only for airport capital and operating costs. FAA, in turn, is responsible for effective oversight of airport revenue.

Over the last 30 years, FAA, our office, and the Government Accountability Office (GAO) have identified serious airport revenue use problems at Venice (Florida) Municipal Airport. In September 2009, at the request of former Senator George LeMieux, we evaluated concerns regarding the Venice Municipal Airport and identified issues warranting a more detailed review of how the City of Venice, the airport sponsor, uses airport revenue. Accordingly, our audit objective was to evaluate whether FAA's oversight ensures that the City of Venice is using airport revenues only for appropriate purposes and that the airport is as self-sustaining as possible. We conducted the audit from June 2010 through March 2011 in accordance with Government auditing standards prescribed by the Comptroller General of the United States. Exhibit A details our audit scope and methodology.

RESULTS IN BRIEF

FAA has not ensured that the City of Venice used airport revenue for appropriate purposes or that the airport is as self-sustaining as possible. For example, in 1998 and 2004, FAA permitted the City (as both the airport sponsor and the provider of municipal functions)[1] to transfer airport properties to itself at prices below fair market value (FMV).[2] Agency policy requires that airport property be sold at FMV. Yet, FAA approved these transactions even though the associated property appraisals were generally 2 to 10 years old and the combined sales price was $1.1 million below the appraised value[3] and $5.2 million below the tax assessed value.[4] In addition, Federal law requires that airport revenue be used only for the airport's capital and operating costs. However, FAA's oversight did not prevent the City from misallocating lease revenue and parking lot improvement costs. Specifically, over a 21-year period, the City diverted over $1.5 million in airport lease revenue to maintain a municipal fishing pier and indirectly charged the airport too much for parking lot improvements. These revenue losses also undermine the airport's compliance with the Federal requirement that airports be as self-sustaining as possible. Had FAA required the City to establish an equitable means of allocating airport property sales and leases and parking lot improvement costs, as much as $6.7 million in lost revenue could have been used to improve the airport's self-sufficiency[5] or cover 3 years of airport operating expenses.

We made five recommendations to improve FAA's oversight of airport property sales and the Venice airport's self-sustainability. FAA concurred or partially concurred with all our recommendations, but we are requesting that the Agency reconsider its position for three of them, particularly its interpretation of FAA's Revenue Use Policy.

BACKGROUND

Venice Municipal Airport (the airport) was built in 1942 as a U.S. Army Air Force training base. Between 1947 and 1964, the Federal Government transferred the property comprising the current airport and surrounding properties to the City of Venice, which now owns and operates the airport. Between 1984 and 2006, FAA awarded the City more than $5.3 million for 11 AIP grants for purposes such as improving runways and taxiways and revising the airport's master plan and airport layout plan.

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[1] Other City functions include maintaining the City fishing pier, owning parks, and operating utilities.

[2] We identified similar issues in a recently completed audit of Stapleton Airport land sales in Denver, CO, where parcels were sold for less than FMV. See OIG Report Number AV-2011-057, "FAA Did Not Ensure Revenue Was Maximized At Denver International Airport," February 28, 2011. OIG reports are available on our Web site at http://www.oig.dot.gov.

[3] The $1.1 million figure is based on appraisals of airport property that FAA provided. FAA agreed to lower the property values because the City argued that the property was "environmentally sensitive."

[4] According to appraisers hired by the City, appraised values are typically 10 to 20 percent *higher* than tax assessed values.

[5] An example of airport self-sustainability is reducing or eliminating the City's need for Federal AIP grants.

As the airport sponsor, the City must comply with U.S. law and FAA policy, including the Surplus Property Act of 1944; the Airport and Airway Improvement Act of 1982; FAA Order 5190.6B, "Airport Compliance Manual," and FAA's Revenue Use Policy.[6] Specifically, the City must receive FMV for the non-aviation use (i.e., lease or sale) of donated land (i.e., transferred from the U.S. Government) and use the revenue for the airport's capital or operating costs in accordance with AIP grant assurances.

FAA is responsible for advising airport sponsors and providing oversight to ensure that they comply with Federal obligations regarding airport revenue, self-sustainability, and other matters. The Agency ordinarily oversees revenue use and self-sustainability by approving the sales of airport property and by concurring with non-aeronautical leases—both of which must be at FMV. FAA also inspects airport sponsors' compliance with Federal airport obligations and investigates allegations of non-compliance by airport sponsors.

Over the past 30 years, the City's use of airport revenue has been the subject of multiple Federal reviews. In 1978, FAA conducted a review[7] that identified several non-aeronautical leases between the airport and various tenants that were below FMV. In 1993, we reported that the City of Venice under-collected $2.4 million in airport revenue due to leasing property below FMV.[8] In 1999, GAO reported[9] that the airport had lost at least $25 million due to leases with rates below FMV. From 2002 to 2004, FAA investigated allegations of revenue diversion regarding the City's lease of airport property to a golf association but did not conclude that diversion occurred.[10] Finally, in 2009, FAA inspected the City's compliance with Federal land-use requirements and identified several potential issues that the Agency is actively pursuing (e.g., non-aeronautical uses of airport property, problematic leases, safety, and maintenance deficiencies).

FAA DID NOT EXERCISE EFFECTIVE OVERSIGHT OF VENICE AIRPORT LAND SALES AND LEASES

FAA did not ensure that all Venice airport property sales and lease transactions followed Federal requirements and FAA policy. In particular, FAA accepted flawed property appraisals and did not validate that the property was environmentally sensitive[11] and therefore of limited value. In addition, FAA did

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[6] "Policy and Procedures Concerning the Use of Airport Revenue," 64 Federal Register 7696, February 16, 1999.

[7] In multiple letters dated 1978, FAA instructed the City to compensate the airport account for 6 years of payments that were below FMV. The leases were with the City, Sarasota County, and the Venice Golf Association.

[8] OIG Report Number R4-FA-3-724, "Airport Revenue Accountability, City of Venice, Florida," July 22, 1993.

[9] GAO Report Number RCED-99-109, "General Aviation Airports Unauthorized Land Use Highlights Need for Improved Oversight and Enforcement," May 7, 1999.

[10] However, based on FAA's investigation, the City increased the lease from $160,000 per year to $180,000 per year.

[11] The City claimed that 15 acres of onsite wetlands and wildlife habitat restricted development of this property.

not require the City to establish an equitable agreement for dividing restaurant lease revenue and parking lot development costs between the City and the airport. As a result, the airport lost significant revenue that could have been applied to operations costs to increase the airport's self-sustainability.

FAA Did Not Ensure Airport Property Was Sold for Fair Market Value

Federal law and FAA policy require that airports receive FMV for all sales or transfers of airport property. However, from 1998 to 2004, FAA approved the transfer of three airport properties to the City for amounts below FMV, as illustrated by table 1. By transferring these properties for less than FMV, FAA and the City did not comply with the Surplus Property Act of 1944, FAA's Airport Revenue Use Policy, and FAA Order 5190.6A. Moreover, FAA did not follow Agency policy, which requires a current appraisal (i.e., within 6 months)[12] by a certified appraiser, and did not ensure that the sales were conducted in an impartial manner.[13]

Table 1. Venice Property Transfers/Sales, 1998–2004

Parcel	Acres	Date Sold	Appraisal Date	Sale Price	Appraisal Value	Difference
Brohard Park	40	1998	1994	$165,000	$1,200,000	$1,035,000
Chuck Reiter Field	9	1998	1996	$250,000	$279,000	$29,000
Wastewater Treatment Site	7	2004	1994	$214,000	$266,000	$52,000
Totals	56			$629,000	$1,745,000	$1,116,000

Source: OIG analysis of airport property appraisals

The combined sales price for these properties was $1.1 million below appraised value and $5.2 million below tax assessed value.[14] This deficit resulted in a diversion of airport revenue that could have been used to fund up to 3 years of the airport operating expenses or to pay for other, much needed airport improvements.[15] Unfortunately, FAA cannot recover these funds because the transactions occurred more than 6 years ago—the statute of limitations established

[12] Although FAA policy does not define "current," the Agency's general practice, or "rule of thumb," is that appraisals should be no more than 6 months old, according to Office of Airports, Southern Region, and Orlando Airports District Office officials.
[13] FMV is based on an impartial transaction in which unrelated parties act in their own best interests.
[14] While FAA does not use tax assessments to establish a property's FMV, such assessments are a standard part of the Florida State appraisal process and a useful point of comparison with property appraisals.
[15] In December 2010, Venice applied for a $4.7 million grant to rehabilitate runway 4/22.

by law.[16] Nevertheless, the losses undermined the airport's self-sustainability and increased its need for AIP grants.

Moreover, since the City requested these transfers and acted as both the buyer and seller, there was an inherent conflict of interest in determining the "highest and best" sales price or FMV for these properties. When an airport sponsor purchases airport land to be used for other purposes (such as city parks or utilities), it is critical that the transactions be conducted in an impartial manner. This is particularly important with Venice, since the City intends to purchase additional airport property.

The following provides a detailed explanation of the three property transactions (shown in table 1).

- **Brohard Park:** In June 1998, FAA approved the City's purchase of 40 acres of airport beachfront property for $165,000 to create a public park. This price was only 14 percent of the property's 4-year-old appraised value of $1.2 million[17] and only 4 percent of the 1998 tax assessed value of $4,677,349. FAA approved this sale even though the City did not provide a map of the property being released, demonstrate how the release would be more beneficial than keeping the property for rental income, or describe the release's benefit to civil aviation—as required by FAA policy. In addition, the appraisal was for a 73-acre parcel, so the lack of a survey map or legal description made it impossible to know whether the transferred property of 40 acres matched the appraised property.

  FAA approved the low sale price based on a letter from the City stating that the airport land was environmentally sensitive and not practical to develop for purposes other than a park.[18] However, FAA did not validate this claim by requiring an environmental assessment or a current, independent appraisal. As a result, FAA failed to ensure the airport received FMV. Specifically, FAA allowed the City to use seven properties to establish a sales price for Brohard Park, even though those properties were not on beachfront land like Brohard Park. The seven properties were also environmentally restricted and therefore inappropriate comparisons. In particular, Brohard Park includes a commercial restaurant and a waste-water treatment facility, demonstrating that environmental sensitivity did not prevent the property's development, including the subsequent expansion of the restaurant and associated parking.

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[16] 49 U.S.C.§ 47107(n)(7) states that "No person may bring an action for the recovery of funds illegally diverted . . . 6 years after the date on which the diversion occurred."

[17] The appraised value per acre was $30,000, which is $2.2 million for 73 acres or $1.2 million for 40 acres.

[18] The letter responded to an FAA request that the City provide additional support for the sale price and the property's environmental sensitivity.

- **Chuck Reiter Field:** In February 1998, FAA approved the City's purchase of a 9.15-acre baseball park on airport property for $250,000. This price was $29,000 less than a 1996 amended appraisal[19] and 85 percent of the 1998 tax assessed value of $292,916. In addition, the map included in the appraisal was for 8.2 acres and FAA's deed of release was for 9.15 acres. The City requested this release to end recurring compliance problems after Federal reviews in 1978 and 1993 determined that the airport was not receiving fair market rent for this property.[20] In approving this transfer, FAA did not comply with its own policy because (1) there was no demonstrated benefit for transferring the property instead of keeping it for rental income,[21] (2) the acreage on the deed of release did not match the appraisal, and (3) the purchase was at a price below FMV.

- **Venice Beach Wastewater Treatment Site:** In February 2004, FAA approved the City's purchase of seven additional acres of airport beachfront property for about $214,000 to develop another park, known as Tramonto Vista Park. The price was below FMV at just 80 percent of the property's 10-year old appraised value and only 26 percent of the 2004 tax assessed value of $836,000. FAA accepted the City's sales price based on a list of the values of 27 environmentally protected properties purported to be comparable to this property; however, these properties were not good comparisons because they did not have the same highest and best use[22] as Tramonto Vista Park and were not on the Gulf of Mexico. In addition, FAA did not follow Agency policy in requiring that the sponsor provide (1) a current, independent appraisal, (2) documentation supporting transfer over retention of the property for rental income, or (3) consistent maps of the property. FAA also identified this latter issue in its 2009 Land Use Inspection and directed the City to provide an accurate survey.

Given these past practices at Venice airport, we have concerns that additional airport property may be transferred at less than FMV. For example, FAA and the City of Venice have proposed releasing the following two airport properties:

- **Maxine Barritt Park:** This park is adjacent to Tramonto Vista Park and consists of 12 acres of beachfront property, including a pond, walkway, and several beach look-out platforms. The pond, which is leased to the City Utilities Department, generates at least $54,000 per year for the airport. In anticipation of acquiring this land, the City hired an appraiser who

[19] The 1996 amendment updated Chuck Reiter Field's FMV as approximately $279,000.
[20] In 1978 FAA instructed the City to compensate the airport $16,268 for diverted revenue, and in 1993 our office determined the rent was $13,104 below fair market rent.
[21] The appraised rental value was less than the existing lease to a baseball league for $25,484 per year and did not include any value for a City water tower and other leases.
[22] Highest and best use is whatever the property could be used for that would produce the highest value or income.

determined that 4 of the 12 acres (land) have a FMV of $585,000 and that the remaining 8 acres (the pond) have no value. The appraisal, however, may have undervalued the property because it did not (1) consider the highest and best use of the land, (2) include the rental income or improvements on the property, or (3) independently verify the maps and legal description.[23] Finally, the appraised value appears low at 29 percent of the property's 2010 tax assessed value of $2 million.

- **Sharky's on the Pier:** In an October 2009 letter, FAA suggested that the City sell airport property being used for a beachfront restaurant, "Sharky's on the Pier," to end recurring complaints and compliance problems regarding this property. The City received appraisals of this property in 1994, 2006, and 2010, following reviews by our office and FAA. However, these appraised values are not only inconsistent, but also appear excessively low when compared to the tax assessed values (see Table 2). For example, the last two appraisals[24] include limited scope, hypothetical zoning, and inappropriate comparisons to inland properties. They were also significantly lower than the tax assessed values, which show a consistent growth. In addition, appraisal values have fluctuated significantly, with the 2010 appraisal being much lower than one performed 16 years earlier (see table 2 below). FAA has indicated that it shares our concerns and will request a review of the 2010 appraisal.[25]

Table 2. Appraisals vs. Tax Assessed Values for Sharky's Property, 1994–2010

Year	Appraisal Values (for 1 acre)	Tax Assessed Value (for 1 acre)
1994	$725,000	$805,860
2006	$217,800	$1,524,816
2010	$482,209	$3,268,127

Source: OIG analysis

These two property transfers will be required to comply with the Surplus Property Act, FAA Order 5190.6B, and FAA's Revenue Use Policy. However, these policies lack explicit guidance to ensure the airport receives FMV when the airport sponsor acts as both the buyer and seller of airport property. FAA has indicated

[23] Each of these steps are part of the Florida guidelines for a standard appraisal report and required by FAA policy.
[24] The 2006 and 2010 appraisals were conducted by the same appraiser.
[25] A review appraisal is an independent review of an existing appraisal to determine its validity and accuracy.

that it is currently reviewing its land release policy in such cases, and may require a review or second appraisal for unique properties, such as Sharky's.[26]

FAA Did Not Prevent the City from Misusing Airport Revenue

Although FAA identified and is addressing a number of lease issues as part of its land use inspection, two significant issues remain relating to Sharky's restaurant and associated parking. Specifically, we found that the City, over a 21-year period, failed to provide the airport its fair share of revenue from the restaurant lease, resulting in the airport losing over $1.5 million. In addition, the City may be indirectly charging the airport too much for parking lot improvements. These losses occurred primarily because FAA has not required the City and the airport to establish an equitable agreement for distributing restaurant lease revenue and allocating improvement costs for parking lot renovations. As a result, the airport has less revenue to ensure self-sustainability.

Insufficient Lease Revenue from Sharky's: We determined that since 1989 the City has underfunded the airport in excess of $1.5 million from the Sharky's lease (see table 3). This occurred because FAA has interpreted its Revenue Use Policy as limiting airport revenue to only FMV land rent, as opposed to also including a portion of Sharky's gross proceeds. Over a 21-year period, the City received about $4.7 million in revenue for the lease, which includes land rent and a percentage of the restaurant's gross receipts. The City distributed about $3.3 million to its Pier Fund (which helps maintain the City's fishing pier) and about $1.4 million to the airport. In contrast, we estimate that the airport should have received nearly $2.9 million of the lease, due to the restaurant being located mostly on airport property.[27]

Table 3. Potential Underpayments to Airport Fund from the Sharky's Lease, 1989–2010

Payments	City Estimate (Millions)	OIG Estimate (Millions)
Amount Owed	$1.6	$2.9
Amount Paid	$1.4	$1.4
Amount Underpaid	$0.2	$1.5

Source: OIG analysis of City financial data

[26] As a result of our February 2011 audit report regarding airport revenue at Denver International Airport, FAA is in the process of amending its guidance for land appraisals and disposals and will likely require a second appraisal for large or unusual properties. (See OIG Report Number AV-2011-057, "FAA Did Not Ensure Revenue Was Maximized at Denver International Airport," February 28, 2011.)

[27] Prior to the 1998 transfer of airport property to the City for Brohard Park, 100 percent of the restaurant and associated parking spaces were located on airport property. Since that time, we estimate—using survey maps and the 2008 lease—that the airport's share of the land used by the restaurant and associated parking has dropped to around 50 percent.

The funds were distributed in this manner based on a series of actions taken by the City. Specifically:

- From 1986, the City leased airport property to the Pier Group Inc. to operate "Sharky's on the Pier."
- Under two separate leases (i.e., 1986 and 2008), the Pier Group agreed to pay the City ground rent and a percentage of the gross receipts from the restaurant, but neither lease specifies any revenue for the airport.
- In 1998, the City passed a resolution[28] with the concurrence of FAA's Southern Region requiring the City Pier Fund to pay the Airport Fund $72,000[29] per year plus Consumer Price Index adjustments.
- In September 2008, the City determined that the airport was entitled to one-third of the entire lease proceeds, based on an estimate that Sharky's and its parking lot occupies one-third of airport property and two-thirds of City property.

FAA's Southern Region reviewed the City's one-third distribution in a 2009 land use inspection report.[30] The review addressed the lease and revenue distribution and accurately identified that less than one-third of the lease proceeds has actually been deposited in the Airport Fund. The Region also concluded that this distribution of lease proceeds could be contrary to grant assurances[31] and may be a revenue diversion. Yet, the land use inspection did not examine whether the City's one-third estimate was an appropriate basis for distributing the lease revenue. Conversely, based on our analysis of airport survey and boundary maps as well as the current lease, we conclude that since 1998, approximately half of the land used by the restaurant and associated parking is on airport property. As a result, the airport should receive a larger share of the lease revenue, which would help maintain the airport's self-sustainability.

While the Southern Region's land use inspection raised the possibility of the airport receiving additional revenue from the Sharky's lease, FAA's Compliance Division has stated that it only requires that the airport receive FMV land rent.

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[28] We identified a number of problems with the 1998 resolution. First, it was based on an outdated 1994 property appraisal. Second, it did not accurately identify the airport property involved. Third, it did not explain the roles and responsibilities of all key stakeholders (i.e., the airport, city, and restaurant owner). Finally, FAA and the City did not seek to update the resolution to comply with FAA's 1999 Revenue Use Policy and to establish an equitable distribution of lease proceeds and capital improvements between the key stakeholders that protects the self-sustainability of the airport.

[29] The $72,000 rent was based on a 1994 appraisal, which established fair market rent as $72,500 per year.

[30] FAA raised various concerns about the distribution of airport revenue in its 2009 land use report, "Land Use Inspection Report, Venice Municipal Airport, Venice, FL," August 10, 2009. This report, however, made no mention of the parking lot improvements.

[31] Under grant assurance 25, *Airport Revenues,* airport sponsors agree that all revenues generated by the airport will be expended by it for the capital or operating costs of the airport; the local airport system; or other facilities which are owned or operated by the owner or operator of the airport.

Since the 1998 resolution, revenues derived from the Sharky's lease have been deposited by the City into its Pier Fund, part of which is then transferred to the Airport Fund as compensation for the use of airport property. Despite the concerns raised by the Southern Region, FAA's Compliance Division considers this use of Sharky's lease revenues appropriate, arguing that the Revenue Use Policy does not dictate that the Airport Fund receive more than fair market *land rent* for non-aeronautical land.[32] The Division officials also stated that the airport is not entitled to additional lease proceeds (i.e., from the restaurant's gross receipts) because it does not share in the risk of entering into and managing the lease.

We disagree with the Compliance Division's position about the additional lease proceeds. According to FAA's Revenue Use Policy, all rent for activities occurring on airport property is considered airport revenue. Specifically, airport revenue includes *"… all … rents … accruing to the (airport) sponsor for any … revenue from … tenants … of airport property…."* In our opinion, the City's distribution of the entire Sharky's lease revenue (i.e., both the ground rent and a percentage of gross receipts) to the Pier Fund—which later distributes some funds to the Airport Fund—is inappropriate because it allows an airport sponsor to benefit by using airport revenue for non-airport projects and compromises the future self-sustainability of the airport.

While we estimate that the airport has been underpaid over $1.5 million from the Sharky's lease, only $493,070 (plus interest) in questioned costs[33] could be returned to the airport fund (see exhibit B) because of the 6-year statute of limitations on recovering unlawful diverted revenue. In addition, we estimate that, over a 5-year period, about $426,329 in future funds (see exhibit C) could be put to better use if the City distributed lease proceeds in accordance with the percentage of leased property that is airport owned.

Excessive Parking Lot Renovation Costs: The City indirectly charged the airport too much for renovations to the parking lot serving Sharky's, the fishing pier, and Brohard Park. In May 2008, the City finished renovations totaling $1,380,647, which transformed a gravel lot into a paved parking lot with 373 spaces. As illustrated in table 4, the Pier Group Inc. contributed $615,000 to the improvements, leaving an outstanding balance of $765,647, which the City distributed

Table 4. City's Allocation of Renovation Costs

Methodologies	Dollar Amount
Pier Group	$615,000
Airport	$255,216
City	$510,431
Total	**$1,380,647**

Source: OIG analysis of City data

[32] FAA also states that the Sharky's lease is unique because airport property leases typically are only for land rent.
[33] According to the Inspector General Act of 1978, a questioned cost is an alleged violation of law, grant, contract, or policy regarding the expenditure of funds.

between itself and the airport. The City calculates that the airport is responsible for $255,216 of the cost, based on its determination that one-third of the property needed for Sharky's is on airport property. While this is one of several methods for distributing the improvement costs, we believe the most accurate and equitable approach—if the airport shares in the gross receipts from the restaurant—would involve charging the airport only about one-seventh ($117,000) of the improvements, since one-seventh (57 of the 373) of the parking spaces are actually on airport land. This method is also consistent with the Revenue Use Policy, which requires that expenditures not exceed the fair and reasonable value of the services provided the airport.

While the City maintains that no airport funds were withdrawn to pay for the renovations, it calculated the airport share to be $255,216, and offset most of these costs by reducing the amount of lease revenue deposited into the airport fund.[34] Nevertheless, as a result of this arrangement, the airport ended up paying for a disproportionate share of the parking lot renovations. This situation occurred, in part, because FAA and the City did not establish a fair and equitable agreement for allocating Sharky's lease revenue and capital improvements costs, such as those associated with the parking lot renovations.

CONCLUSION

The budget constraints now facing FAA and the financial strains on the Nation's airlines and airports underscore the need for vigilant oversight of airport revenue use. Because FAA did not effectively oversee the lease and sale of property at Venice, the airport has lost and will continue to lose revenues that could be used to reduce its reliance on Federal funding. Of particular concern is the adverse effect on the sale price when the airport sponsor is both the seller and buyer of airport properties—an area that FAA policies currently do not explicitly address. FAA must strengthen both its oversight and its policy to ensure that airports are as self-sustainable as possible and that the airport sponsors do not misuse revenues from sales and leases at the airport's—and taxpayers'—expense.

[34] In August 2011, Venice City officials reiterated that no airport funds were used to pay for the parking lot renovations. However, on at least two occasions in July 2010, a senior City official explained and provided OIG auditors documentation showing that funds due the airport fund were offset by the $255,216 in parking lot improvement costs.

RECOMMENDATIONS

We recommend that FAA:

1. Strengthen Agency policy to ensure that transfers of airport property acquired through Federal assistance are based on independent certified appraisals performed within 6 to 12 months of the transfer and reviewed by an independent real estate professional, especially when the parcel is unusual or the transfer is between an airport and its sponsor.

2. Require the City to complete the independent review appraisal of the property used by the Sharky's restaurant if sold, and any subsequent transfers of airport property.

3. Assess the revenue diversions or self-sustainability issues involving the distribution of Sharky's lease revenue and parking lot renovation costs and seek full recovery, plus interest on the $493,070 in questioned costs identified by our office (see exhibit B) and any other improperly allocated revenue identified by FAA.

4. Work with the City of Venice to develop an appropriate allocation of future rent revenue from Sharky's over the remaining term of the lease and the cost of subsequent capital improvements such as parking lot renovations, that protects the self-sustainability of the airport.

5. Assess the adequacy of the Agency's policies and procedures for overseeing the transfer or lease of large or unusual airport properties to ensure that sponsor agreements are fair and equitable and protect the airport's self-sustainability.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

We discussed the results of our review with officials from FAA's Airport Compliance Division on March 23, 2011 and provided the Agency our draft report on July 27, 2011. We received FAA's formal response on September 21, 2011, and have included it as an appendix to this report. In its response, FAA concurred with four recommendations and partially concurred with the fifth. Overall, FAA's response meets the intent of recommendations 1 and 2, and we consider these recommendations resolved but open until the Agency completes its planned actions. We also ask that FAA provide us a target date for the completion of its actions for recommendation 2.

For recommendations 3, 4, and 5, FAA’s response and planned actions only partially meet the intent of our recommendations, and we are asking that the Agency reconsider its responses. Specifically:

- FAA partially concurred with recommendation 3, stating that it would assess revenue diversion and self-sustainability questions regarding the Sharky’s property. However, the Agency disagreed with our interpretation of the Agency’s Revenue Use Policy, stating that this policy only requires that the airport receive fair market rental value for the Sharky’s property. The Agency did not explain why all the lease revenue is not airport revenue, as stated in Section II of the Revenue Use Policy. Considering the sizable lease revenue that the City did not distribute to the airport, we believe this matter merits reconsideration. In effect, the City rents the Sharky’s property from the airport at one rate and leases it to a third party at a higher rate. We are also concerned about the precedent that this situation sets. Other airport sponsors could establish a similar mechanism, allowing them to siphon off airport lease revenue that could better be applied to ensuring the self-sustainability of the airports. Accordingly, we request that FAA reconsider its interpretation and application of the Revenue Use Policy.

- FAA concurred with recommendation 4, stating that the airport should avoid all costs associated with the Sharky’s property and that the airport administrator should not help manage it. While we agree that the airport should not manage this property, we disagree with the Agency’s approach to addressing this recommendation, which is tied to its response to recommendation 3: FAA believes the airport is only due fair market land rent instead of the full rent revenue from the airport property. As a result, we request that FAA reconsider its position in response to recommendation 4.

- FAA concurred with recommendation 5 and stated that it is assessing practices for the disposal or lease of large properties and planning to complete a draft policy in February 2012. While this assessment should help improve FAA oversight, FAA’s response does not adequately address smaller, atypical airport properties, such as those belonging to the Venice airport. FAA states that additional oversight for these properties may not be justified on a cost-benefit basis. While we agree that FAA needs to be judicious with its resources, we think that airports with a history of compliance issues and other unique attributes, such as Venice, would benefit from the improved oversight practices that the Agency is developing. Therefore, we request that the Agency reconsider its position in response to recommendation 5.

ACTIONS REQUIRED

FAA's proposed action for recommendation 1 is responsive, and we consider it addressed but open pending completion of the planned action. For recommendation 2, we are asking FAA to provide us a target completion date for its review of the Sharky's property appraisal. For recommendations 3, 4, and 5, we are asking the Agency to reconsider its position. We request that FAA provide us this additional information within 30 days.

We appreciate the courtesies and cooperation of FAA and City of Venice representatives during this audit. If you have any questions concerning this report, please contact me at (202) 366-0500 or Darren Murphy, Program Director, at (206) 220-6503.

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cc: FAA Deputy Administrator
Acting Assistant Administrator for Airports
Anthony Williams, ABU-100
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EXHIBIT A. SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions. We conducted the audit between June 2010 and March 2011 and included such tests of procedures and records as we considered necessary, including those providing reasonable assurance of detecting abuse and illegal acts.

To determine whether FAA oversight ensures that the City is using airport revenues for appropriate purposes, we interviewed officials from the City, Airport, and FAA's Compliance Division, Southern Regional Office, the Orlando Airport District Office (ADO), as well as airport tenants and community interest groups. We then reviewed FAA, City, and Airport policies and procedures on revenue use to ensure the airport sponsor complied with AIP grant assurances and Federal land use requirements. To identify prior audit findings, we analyzed consolidated annual financial statements, single audits, OIG reports, and GAO reports.

To assess whether airport funds were used for the capital and operating costs of the airport, we reviewed a statistical sample of 53 airport payments equaling $145,894 which were pulled from a total population of 1,303 payments representing $5,571,284. We relied on data maintained in the City accounting system and verified its accuracy during testing of sampled transactions. To verify that funds were expended in accordance with AIP grants agreements, we reviewed all grant files at the Orlando ADO and the supporting documentation for the four most recent AIP grants at the City of Venice. To assess whether there is a basis for allocating costs and whether the methodology is consistently applied, we analyzed the most recent cost allocation plans for fiscal years 2005, 2006, and 2007. To obtain an interpretation of FAA's Revenue Use Policy regarding the definition of airport revenue, we met with legal counsel from our office and the Office of the Secretary and reviewed relevant policy and Federal law.

To determine whether the airport was receiving FMV for land sales, we reviewed FAA and City documents including property appraisals, deeds, surveys, maps, and tax assessed values of airport land, and interviewed FAA and City officials, as well as two Florida real estate appraisers and the Sarasota County Tax Assessor's Office. We reviewed the appraisals to determine whether they were independent, based on comparable sales, and considered the highest and best use of the property. To assess whether the sales price was appropriate, we compared the sales price with the appraised and tax assessed values.

To determine whether FAA oversight ensures that Venice Municipal Airport is as self-sustaining as possible, we obtained and reviewed non-aeronautical and aeronautical lease agreements and Consumer Price Index adjustments to determine the proper rental payments owed the airport. To confirm where non-aeronautical leases are issued at FMV we compared the appraised value to the rental amount outlined in the lease. Further, to confirm whether the airport fund receives funds as required in the lease agreements, we obtained the lease deposits from the City and compared the deposits to the amounts required in the lease agreements.

To determine the universe of airport property, we interviewed ADO and airport officials and analyzed City and airport files, including quit-claim deeds, survey maps, appraisals, and airport layout plans. We then toured the airport and compared the airport property to existing leases to identify parcels without a current lease. We also interviewed the surveyor hired by the City for the 2010 survey of airport property. We reviewed FAA policy and interviewed ADO officials to determine if a lease was required. To quantify the airport's percentage of land leased for Sharky's restaurant and to validate the proper distribution of revenues between the City and the airport we relied on the expertise of OIG engineers to analyze leases, maps, property boundaries, and a 1998 City resolution.

EXHIBIT B. UNDERPAYMENTS TO AIRPORT FUND

Time Frame	Total Lease Proceeds	Total Deposits to Airport Fund	Estimated Amount Due Airport Fund[35]	Total Under-payment to Airport Fund
1989–1990	$60,434.00	$19,320.00	$60,434.00	($41,114.00)
1990–1991	$71,108.50	$19,320.00	$71,108.50	($51,788.50)
1991–1992	$95,812.00	$21,252.00	$95,812.00	($74,560.00)
1992–1993	$127,501.55	$21,252.00	$127,501.55	($106,249.55)
1993–1994	$137,994.00	$21,252.00	$137,994.00	($116,742.00)
1994–1995	$153,793.00	$21,252.00	$153,793.00	($132,541.00)
1995–1996	$155,121.00	$36,000.00	$155,121.00	($119,121.00)
1996–1997	$163,498.00	$72,000.00	$163,498.00	($91,498.00)
1997–1998	$173,551.00	$72,000.00	$173,551.00	($101,551.00)
1998–1999	$179,211.00	$73,584.00	$89,605.50	($16,021.50)
1999–2000	$203,026.00	$75,056.00	$101,513.00	($26,457.00)
2000–2001	$221,789.00	$76,557.00	$110,894.50	($34,337.50)
2001–2002	$224,553.00	$78,089.04	$112,276.50	($34,187.46)
2002–2003	$235,737.00	$79,650.00	$117,868.50	($38,218.50)
2003–2004	$252,297.00	$81,243.00	$126,148.50	($44,905.50)
2004–2005	$290,882.00	$82,868.04	$145,441.00	($62,572.96)
2005–2006	$342,430.00	$85,353.96	$171,215.00	($85,861.04)
2006–2007	$370,081.00	$95,000.04	$185,040.50	($90,040.46)
2007–2008	$393,507.00	$97,850.04	$196,753.50	($98,903.46)
2008–2009	$394,327.00	$97,850.04	$197,163.50	($99,313.46)
2009–2010	$407,268.00	$147,255.00	$203,634.00	($56,379.00)
Total 2004–2010	**$2,198,495.00**	**$606,177.12**	**$1,099,247.50**	**($493,070.38)**
Total 1989–2010	$4,653,921.05	$1,374,004.16	$2,896,367.05	($1,522,362.89)

[35] Prior to 1998, the airport contributed 100 percent of the land leased to the Pier Group, Inc. (owners of Sharky's restaurant). This amount dropped to around 50 percent after FAA approved the transfer of airport land to the City for Brohard Park in 1998.

EXHIBIT C. FUTURE UNDERPAYMENTS TO AIRPORT FUND

Time Frame	Total Lease Proceeds	Total Deposits to Airport Fund	Estimated Amount Due Airport Fund	Total Under-payment to Airport Fund[36]
2010–2011	$435,884.71	$143,841.96	$217,942.36	($74,100.40)
2011–2012	$466,504.86	$153,946.60	$233,252.43	($79,305.83)
2012–2013	$499,268.42	$164,758.58	$249,634.21	($84,875.63)
2013–2014	$534,325.43	$176,327.39	$267,162.72	($90,835.32)
2014–2015	$571,836.43	$188,706.02	$285,918.22	($97,212.19)
Total 2010–2015	**$2,507,819.86**	**$827,580.55**	**$1,253,909.93**	**($426,329.38)**

[36] We based our estimate on the following: (1) 5-year average of the increase restaurant's gross receipts, (2) 50 percent of the lease involves airport property, and (3) the City's previous practice of allocating one-third of the lease rent to the airport fund.

EXHIBIT D. MAJOR CONTRIBUTORS TO THIS REPORT

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Federal Aviation Administration

Memorandum

Date: SEP 21 2011

To: Jeffrey B. Guzzetti, Assistant Inspector General for Aviation and Special Program Audits

From: H. Clayton Foushee, Director, Office of Audit and Evaluation, AAE-1

Subject: OIG Draft Report: FAA Did Not Exercise Effective Oversight of Land Sales and Leases at Venice Municipal Airport Federal Aviation Administration

The Federal Aviation Administration (FAA) has a long history of conducting careful oversight of Venice Municipal Airport (VNC) including analyses of its unique land use and financial issues. During the past several years, FAA oversight has balanced the many demands on its limited airport office resources with sufficient focus on the complicated details involved at VNC, in an effort to ensure that VNC remains in compliance with its Federal obligations. The FAA has conducted various reviews and investigations at VNC including an airspace compatibility audit, an Airport Layout Plan alternatives analysis, and formal and informal complaint investigations. As a result, the FAA has counseled the City of Venice on numerous occasions with regard to such issues as reasonable access to aeronautical leases, aeronautical access, maintaining airport pavements, and airport runway configurations. In some cases, the FAA has denied the requests of the City, and these actions have preserved the utility of VNC for aeronautical uses.

In addition to these activities, in May 2009, the FAA conducted an extensive Land-Use Inspection at VNC. The FAA issued its report in August 2009, preceding the initiation of the OIG review in 2010. FAA's inspection identified many of the issues now included in the Office of Inspector General (OIG) report with regard to leases. We required the City of Venice to respond to our concerns, including the concern on leasehold valuations discussed further below.

Background

The circumstances at VNC are unusual. The VNC properties are beachfront parcels with development restrictions and environmental degradation, including an archaic wastewater treatment plant. One parcel constitutes a lease of beachfront property that is closely integrated with a city-built, owned and maintained, 700-foot long fishing pier extending into the Gulf of Mexico and along with an associated restaurant, bar, and bait shop concession -- *Sharkey's on the Pier* -- operated by Venice Pier Group, Inc. [Figure 1.] This exclusive concession is located partly on the Venice Fishing Pier.

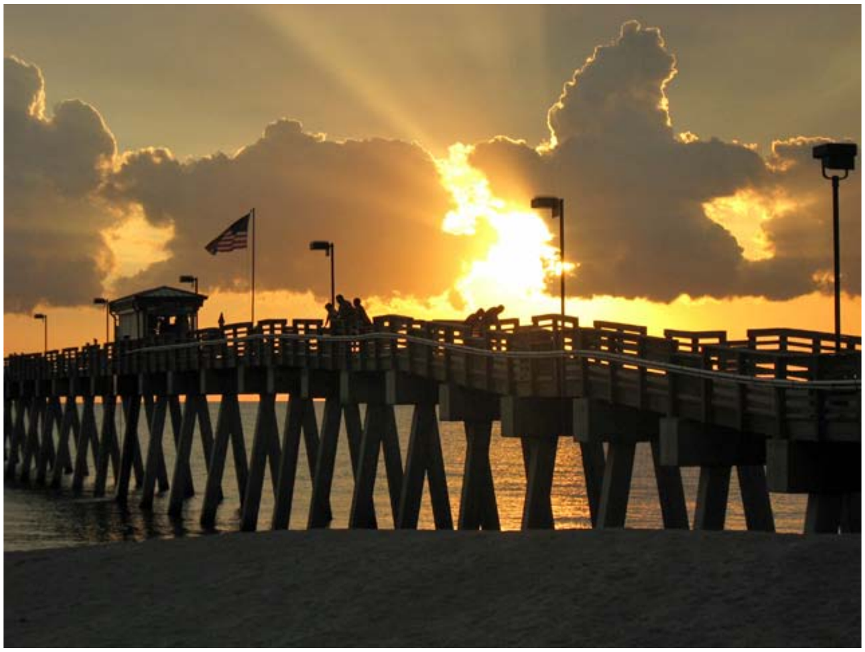

Figure 1 Venice Fishing Pier over the Gulf of Mexico with Bait and Snack Shop operated by *Sharkey's on the Pier*.

The Revenue Use Policy allows the FAA to conclude that an airport sponsor is compliant with the Revenue Use Policy and Federal law if it demonstrably receives no less than fair market value (FMV) for a lease or sale of an asset paid into the airport account. The FAA policy recognizes that it is common for airport sponsors to lease or sell airport property[37] for non-aviation purposes. Airport sponsors must only allow land uses that are compatible, or do not interfere, with aviation activity, including commercial, industrial, or agricultural uses that produce revenue for the airport account. FAA requirements on land disposals include similar compatibility restrictions for land uses after a disposal. The appraised value of airport properties should consider the value effects of compatible land-use restrictions in light of FAA's policy and practice with regard to financial self-

[37] The Federal Government transferred VNC to the City in the 1940s. As such, the airport property is subject to Federal Surplus Property obligations, in addition to its obligations under the City's Federal AIP grant assurances.

sustainability requirements.[38] FAA requires the sale price or lease of airport property, including surplus property, to be at the FMV of the land. The FMV of airport property is the highest current market price of the land to be sold for compatible use and development with the adjoining airport. On the one hand, the FAA wants the sponsor to pursue compatible land-uses for aeronautical activity as its prime obligation. On the other hand, the FAA wants the sponsor to pursue financial benefits to the airport. As a matter of policy, the FAA has settled on the airport account receiving fair market value of airport compatible uses as the standard for compliance.

FAA Agrees with Land Valuation and Disposal Issues but Disagrees with the OIG's Conclusions with regard to VNC Lease Revenue

Based upon its experience with VNC through its oversight activities, the FAA agrees with some recommendations of the OIG report, including improving policies regarding the timing of airport sponsor land disposals and land appraisal, requiring review appraisals in certain circumstances of land disposal or lease, and reviewing the future valuation of property and allocation of some lease revenues at VNC. However, the FAA disagrees with the OIG's interpretation of certain facts at VNC with regard to the application of long-standing FAA policy.

For example, although the report alleges that the City diverted lease revenue to maintain the municipal fishing pier, the FAA neither knows of any investment of airport account funds into the construction or maintenance of the Venice Fishing Pier, nor does the report provide any evidence of such investment. Further, the OIG report asserts that the airport should have received more gross receipts proceeds, in addition to FMV rent, from a restaurant/bar/bait shop concession at the Venice Fishing Pier on and adjacent to airport property. The FAA believes that this conclusion may be based upon a misinterpretation of FAA policy. Specifically, the airport account is not required under FAA's *Policy and Procedures Concerning the Use of Airport Revenues* (Revenue Use Policy) to collect <u>both</u> FMV rent <u>and</u> a percentage of gross revenue.

RECOMMENDATIONS AND RESPONSES

OIG Recommendation 1. *Strengthen Agency policy to ensure that transfers of airport property acquired through Federal assistance are based on independent certified appraisals performed within 6 to 12 months of the transfer and reviewed by an independent real estate professional, especially when the parcel is unusual or the transfer is between an airport and its sponsor.*

FAA Response: Concur. The FAA is working to refine appraisal requirements for land sales and transfers. We recognize that the market value of land is "as-of a specific date of a sale," and as a result of an "arms length" transaction and meeting other FMV criteria. Comparable land sales are adjusted for changed market conditions from the sale date of a

[38] This is also the standard for revenue retention requirements under the Revenue Use Policy, Sections VI and VII.

property in the past to the date of value of the appraisal. For example, more recent sales prices provide more reliable indicators of actual market value.

For internal land transfers between the airport and agencies of the airport owner, the FAA is considering requiring all applicants to set a settlement date and to set the sales price based on a current appraisal (and appraisal review as needed) with a date of value within 6 to 12 months of the proposed transfer date. The setting of a reasonable settlement date will assist the FAA and airport sponsors to better manage the many transactions of smaller monetary value. FAA intends to complete a draft of its revised requirements by February 28, 2012.

OIG Recommendation 2. *Require the City to complete the independent review appraisal of the property used by the Sharkey's restaurant if sold, and any subsequent transfers of airport property.*

FAA Response: Concur. The FAA requested a review appraisal based upon the agency's 2009 land use inspection and received a review appraisal from the City dated April 13, 2011. The FAA is reviewing the appraisal, but has not received an application for release, sale and disposal of the *Sharkey's on the Pier* parcel. The FAA agrees that the *Sharkey's on the Pier* parcel should be priced at FMV if sold to the City's Pier Fund or sold to *Sharkey's on the Pier* leaseholder.

OIG Recommendation 3. *Assess the revenue diversions or self-sustainability issues involving the distribution of Sharkey's lease revenue and parking lot renovation costs and seek full recovery as necessary, plus interest of the $493,070 in questioned costs identified by our office (see exhibit B) and any other improperly allocated revenue identified by FAA.*

FAA Response: Partially Concur. The FAA concurs that it should further assess the questions of revenue diversion and/or self-sustainability involving the *Sharkey's on the Pier* parcel lease arrangement on the margins. However, the FAA does not accept the OIG report's interpretation of FAA policy or its allocation of the *Sharkey's on the Pier* parcel's costs and revenues cited in the draft report.

The FAA disagrees with the OIG report's specific finding that the airport should have received more of *Sharkey's on the Pier* gross receipts proceeds in addition to FMV rent. The airport account is not required under FAA's Revenue Use Policy to collect <u>both</u> FMV rent <u>and</u> a percentage of gross revenue. Accordingly, the FAA concludes that an airport sponsor is compliant with the Revenue Use Policy and Federal law if it demonstrably receives no less than FMV for assets duly attributed to the airport account. [See Revenue Use Policy, Section VII.]

Commonly, rent structures for retail concessions can be either FMV rent or a minimum annual guarantee (MAG) with a percentage rent based upon sales volume. In the former, the landlord's role is passive and the transaction is based strictly on the use of property, with the landlord assuming no risk. The landlord receives FMV rent whether the business is successful or a failure. In the latter, percentage rents with MAGs provide for revenue sharing, and the landlord's rent is based upon the concessionaire's ability to generate sales volume and grow the business. Landlords tend to set MAGs at a lower level than FMV rent, with an initial objective of covering the property's costs. By setting a low MAG, the landlord expects to participate in the concessionaire's success as sales volume increases and the business grows. Conversely, if the concessionaire is unsuccessful, the landlord bears the financial risk and the potential loss of revenue.

While some airports may have the expertise to manage this type of risk, many clearly do not. Therefore, it is longstanding FAA policy that airport development is better served by requiring, at minimum, the use of the less financially risky FMV rent-based approach. This arrangement allows airports to focus on the management and development of the airport business and avoiding exposure to non-aviation businesses. The FAA does recognize, in the case of VNC, that the airport is receiving FMV rent and shares in some additional revenue generated by *Sharkey's on the Pier*. However, the FAA does not agree that the Revenue Use Policy requires that airports receive both FMV rent and a percentage of gross receipts.

Figure 2 Access to the fishing pier is integrated into *Sharkey's on the Pier*'s leasehold.

We are concerned about the implications of the OIG's argument that all rents for the use of non-aeronautical airport property, accruing to the airport owner in its role as operator of a municipal enterprise, should be considered airport revenue. Based upon the OIG's premise, airport sponsors could no longer lease land to other municipal enterprise departments without assuming an additional burden for the operation of that business. Such an undertaking would require airport managers to develop or hire personnel with expertise in operating convention centers, animal shelters, golf courses, wastewater treatment plants, etc.

The FAA does not believe that the airport should pay for any of the parking lot renovations because airport revenue should not be used to support the capital or operating costs associated with a non-aviation use of airport property. As such, FAA will seek reimbursement to the airport account of all airport revenue invested in the parking lot.

Since the airport account is receiving a set rent, with escalators, based on FMV, it should not be burdened with investments that serve to increase the gross receipts of the *Sharkey's on the Pier* concession and the pier itself. The city, through its Pier Fund, is building, operating, and maintaining the pier. The City is taking the risk of the relative success of the pier concession as part and parcel of the pier operation.

OIG Recommendation 4. *Work with the City of Venice to develop an appropriate allocation of future rent revenue from Sharkey's over the remaining term of the lease and the cost of subsequent capital investment such as parking lot renovations, that protects the self-sustainability of the airport.*

FAA Response: Concur. The FAA has determined that the best strategy for VNC is to avoid all costs associated with the one-acre parcel *Sharkey's on the Pier* Parcel, allowing the Pier Fund to absorb the cost and risk of financing non-airport related capital improvements, including the capital and operating costs of the pier site. Requiring that airport managers be involved in managing all enterprises, no matter how unrelated to aviation, or how capital intensive, is not sound Federal policy for airports. Allowing the Pier Fund to finance and operate the pier and to collect some gross receipts rent from *Sharkey's on the Pier* as the sole concessionaire for the pier is a reasonable financial arrangement that is in accord with FAA policy. This structure requires the concessionaire to contribute to the costs of providing the attraction (fishing pier). However, this option should reflect FMV for airport property, and it should not assess capital costs to the airport account for improvements that assist the revenue potential of the pier concession.

OIG Recommendation 5. *Assess the adequacy of the Agency's policies and procedures for overseeing the transfer or lease of large or unusual airport properties to ensure that sponsor agreements are fair and equitable and protect the airport's self-sustainability.*

FAA Response: Concur. The FAA acknowledges that the disposal or lease of large, complex or unusual parcels are worthy of careful consideration. Therefore, in conjunction with the FAA's review and redrafting of internal guidance on best practices with regard to the valuation of closed and replaced airport property that necessarily involves relatively large parcels (entire closed airports), the FAA is assessing its practices. This guidance will address when to require a second appraisal for this kind of large, complex and/or unusual disposal. FAA anticipates completing a draft of internal guidance for review by February 28, 2012. Further, the FAA is considering adopting standard procedures for related matters including a schedule for required appraisals, establishment of a settlement date for transactions between the sponsor and itself, and a standard memorandum of agreement to review the timeline for the appraisal, the transfer, and for verified financial payments to the airport account.

However, for smaller transactions, such as the subject of the draft report, additional scrutiny may prove difficult to justify on a cost/benefit basis. While the circumstances surrounding the VNC are particularly unique, in light of its location near the beach, from a system-wide perspective, FAA has in place the types of controls including on-site financial reviews of commercial service airports that are sufficient to ensure that non-airport use of airport property affords the airport fund FMV compensation in accord with

FAA policy. Based upon the available information, the type of situation at VNC is insufficient, in and of itself, to justify any significant increase in oversight, or a significant revision of policy considering finite airport oversight resources.

During the course of the audit, we met with the OIG audit team to convey our concerns from a legal and programmatic basis. We appreciate the OIG's consideration and participation in those meetings and are grateful for those areas where these efforts helped to achieve a consensus.