

**LOAN DEFAULT COULD RESULT IN
MISUSE OF FUNDS AT TULSA
INTERNATIONAL AIRPORT**

Federal Aviation Administration

Report Number: AV-2004-058

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Memorandum

U.S. Department of
Transportation

Office of the Secretary
of Transportation
Office of Inspector General

Subject: **ACTION:** Loan Default Could Result in Misuse
of Airport Funds at Tulsa International Airport
AV-2004-058

Date: May 6, 2004

From: Alexis M. Stefani 
Principal Assistant Inspector General
for Auditing and Evaluation

Reply to
Attn. of: JA-10:x60500

To: Federal Aviation Administrator

This report presents the results of our review of potential misuse of airport funds at Tulsa International Airport (Airport). Our objective was to determine whether the Airport's agreement to purchase property used as collateral in a loan to Great Plains Airlines (Great Plains) could result in the misuse of airport funds.

RESULTS IN BRIEF

In responding to a request from Senator James M. Inhofe, we reviewed loan transactions involving the Tulsa International Airport.¹ Specifically, the Airport entered into an agreement with the Tulsa Industrial Authority (TIA)² that may require the Airport to purchase property used as collateral in a loan to Great Plains. This agreement appears to have been made without regard to the fair market value of the property or whether the Airport had a valid need to purchase the property to make airport improvements.

The Airport planned to use \$9.1 million generated from Passenger Facility Charges (PFC) to purchase 30 acres of property for a runway and taxiway extension. The property the Airport planned to purchase was used as collateral for a \$30 million loan to Great Plains as part of an agreement between the Airport,

¹ The Tulsa International Airport is leased to Tulsa Airports Improvement Trust (TAIT). TAIT is a trust sponsored by the City of Tulsa for improving the buildings, structures, and facilities of Tulsa area airports. TAIT is the entity that the Federal Aviation Administration recognizes for purposes of Airport Improvement Program grants and Passenger Facility Charges project approvals. All references to the Airport in this memorandum are synonymous with TAIT.

² The Tulsa Industrial Authority is an agency created to promote the general economic welfare of Tulsa area citizens. The City of Tulsa directly benefits from activities of the Authority.

TIA, and the Bank of Oklahoma. Under this agreement, if the airline defaults on the loan, the Airport would purchase the property at an amount equal to the outstanding debt owed by the airline.

While use of PFC funds to purchase property for airport projects can be appropriate to enhance capacity or safety,³ this potential property transaction raises serious questions because (1) the fair market value of the 30 acres the Airport planned to purchase appears to be significantly lower than the amount of PFC funds the Airport requested to collect, and (2) prior project descriptions in the Airport's capital improvement plans did not identify a need for this property. Further, the Airport did not provide support in its PFC application to show that the property was needed to extend the runway and taxiway.

In a September 2003 application, the Airport requested approval to collect and use approximately \$10.2 million in PFC funds to finance a runway and taxiway extension project, including the acquisition of 30 acres of land. Because the Airport did not provide sufficient details to clarify its need for the land, the Federal Aviation Administration (FAA) requested that the Airport provide supplemental information to support its request, including documentation of the amount budgeted for the land acquisition. In response, the Airport indicated that approximately \$9.1 million was needed to acquire 30 acres of land. The Airport did not provide any documentation to indicate the fair market value of the land. In December 2003, FAA advised the Airport that it would not approve the land acquisition portion of the project, indicating that it did not have sufficient information to determine if the land acquisition was an eligible PFC project.

On January 23, 2004, Great Plains filed for Chapter 11 bankruptcy. Although it received a 90-day extension to repay the loan (originally due in December 2003), the extension expired on March 21, 2004. Great Plains still owes about \$7 million of the loan amount. If the Bank declares Great Plains in default, the terms of the support agreement require the Airport to purchase the property for the outstanding balance of the loan. According to documentation provided to us by an Airport official, the Airport has until December 2005 to obtain the funds to meet its obligation to purchase the property.

FAA policies and procedures prohibit airports from providing direct subsidies to airlines.⁴ In a legal analysis prepared at the request of Airport management on FAA's revenue diversion policy, it was noted that:

³ 49 U.S.C. Section 40117; Passenger Facility Charge, FAA Order 5500.1, (August 9, 2001).

⁴ FAA Policy and Procedures Concerning the Use of Airport Revenue, 64 Fed. Reg. 7696, 7709-10, (February 16, 1999).

In light of the current law, regulations and regulatory pronouncements concerning airport requirements for self-sufficiency, the avoidance of revenue diversion, and prohibition against direct subsidy of air carrier operation or service, we are lead [sic] to the conclusion that to avoid regulatory scrutiny, TAIT's support of the Tulsa Industrial Authority - Bank of Oklahoma [BOK] financing for Great Plains Holding Company et al. must be in the nature of a real estate transaction. Even with the transaction structured in that nature, we are not in a position to opine that in the event of a trigger event which would require TAIT action under the Support Agreement, the use of airport revenues to purchase all or a portion of Air Force Plant No. 3 would not be subject to regulatory scrutiny or audit. However, we believe that to the extent the real estate transaction can be narrowed by the size, nature or character of property and/or facilities encumbered by the TIA-BOK transaction, that would dramatically lessen our concern of regulatory review and/or audit of the "support" transaction.

By becoming a party to the real estate transaction to help finance the start-up of the airline and agreeing to pay off any outstanding loan balance, the Airport incurred a contingent liability that will remain until the airline pays the loan in full. However, should the loan be declared in default and the Airport be required to pay off the outstanding loan balance, this action would constitute a direct subsidy to the airline in violation of FAA policy. Further, should the Airport use Airport funds to pay off the loan, it would result in either a diversion of Airport revenue, inappropriate use of PFC funds, or both.

In the event that Great Plains defaults, FAA should take steps to ensure that the Airport does not divert revenues intended for legitimate Airport purposes to pay off the loan. In addition, FAA should evaluate the appropriateness of the Great Plains loan transaction and establish policies that prevent airport sponsors from entering into agreements that could result in the misuse of airport funds.

Recommendations

To ensure that the Airport does not inappropriately use PFC or other Airport funds to purchase the property, we are recommending that FAA require the Airport to:

- Support any future requests to fund property acquisition costs for the 30 acres of land with a valid appraisal of the property, and
- Validate that there is a legitimate need to acquire the property to extend the runway and taxiway.

In addition, FAA should:

- Ensure that Airport funds are not inappropriately disbursed to cover the cost of the Great Plains loan, and
- Evaluate the appropriateness of the Great Plains loan transaction and establish policies that will preclude airport sponsors from entering into agreements (similar to the one used to support the Great Plains loan) that create contingent liabilities and place airport funds at risk of being used for purposes not permitted under Federal law.

BACKGROUND

Early in 2000, a Tulsa economic development group recommended that the City of Tulsa support a loan to Great Plains. Great Plains would provide direct air service from Tulsa to U.S. east and west coast locations. City officials believed that helping Great Plains would fuel economic development in the Tulsa area. The City of Tulsa transferred 344 acres of land adjacent to the Airport to the TIA so that TIA could use the land as collateral for the loan to Great Plains. On December 21, 2000, the Bank of Oklahoma (Bank) and TIA entered into a loan agreement to issue two revenue notes of \$15 million each. TIA then provided a loan totaling \$30 million to Great Plains.

Also on December 21, 2000, the Bank, TIA, and Tulsa Airports Improvement Trust signed a separate “support agreement” in which the Airport agreed that if Great Plains defaulted on its loan, the Airport would purchase the property for an amount equal to the outstanding debt owed by Great Plains plus any other unpaid amounts due under the loan agreement (i.e., interest and collection costs, which include attorney fees of a minimum of 15 percent of all sums payable).

In 2001, Great Plains paid back one of the \$15 million revenue notes using state-issued tax credits. Since the agreements were signed, the Bank has disbursed \$8.25 million to Great Plains from the second \$15 million note. The remaining \$6.75 million was held in an escrow account to protect the Bank’s interest in the loan.

Under the terms of the note, Great Plains was required to make monthly payments until December 21, 2003, at which time it was to have paid the outstanding loan amount in full. In January 2004, we were informed by an Airport official that the Bank granted Great Plains a 90-day extension to repay the loan. According to the City official, Great Plains still owes the Bank approximately \$7 million.

SCOPE AND METHODOLOGY

The audit was conducted between March 2003 and April 2004. Our review included interviewing officials from the Airport, the City of Tulsa, and FAA; reviewing Airport documents related to the loan transaction with Great Plains; reviewing correspondence related to the Airport's request for PFC funds; and reviewing FAA policy and procedures related to the use of PFC and Airport Improvement Program funds. The audit was conducted in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States and included such tests as we considered necessary to provide reasonable assurance of detecting abuse or illegal acts.

FINDING AND RECOMMENDATIONS

In our opinion, there is a significant risk of the misuse of Airport funds if Great Plains defaults on the loan and the Airport is required to buy the property used as collateral.⁵ The Airport requested approval to use PFC funds to purchase 30 acres of the property to extend a taxiway and runway.⁶ The airport could not provide, nor could we find, a property appraisal that would substantiate the value of the 344 acres used as collateral. However, a Great Plains document indicated that the value of the collateral may be only \$3 million, which is substantially lower than the \$9 million the Airport requested to collect in PFC funds to purchase 30 of the 344 acres. Also, we question whether the Airport has a valid need for the 30 acres because the need to purchase the land to extend the taxiway and runway was not identified in the Airport's description of the runway/taxiway extension project until 2003, after the risk of a potential default became apparent. Key documents and our analyses are summarized below.

- In an August 2000 memorandum, Airport management noted that if Great Plains defaulted, the Airport could use the following sources or a combination of these sources to pay off the loan: "Discretionary funds of the Airport Trust...; Imposition of a Passenger Facility Charge; Facility funding under the Airline Use and Lease Agreements...; FAA entitlements and/or discretionary grants; [or] Special Facility Revenue Bond Financing...."
- In December 2000, the Bank, TIA, and Airport entered into a support agreement that obligated the Airport to purchase the property if Great Plains

⁵ According to loan and support agreement documentation, 344 acres of land adjacent to the Airport was initially provided as collateral for the loan to Great Plains. However, once the airline received its operating certificate or within 15 months of the loan, TIA was to transfer all but 25 acres of the land back to the City of Tulsa. Therefore, the Airport would be required to purchase the remaining 25 acres at an amount equal to the outstanding loan balance.

⁶ Our review of land maps included in the PFC application and loan documents determined that the 30 acres the Airport wanted to purchase is part of the 344 acres of land originally used as collateral for the loan.

defaulted on its loan. Based on our review, the Airport recognized that FAA regulations prohibited it from providing a direct subsidy to an airline; therefore, the Airport made a decision to construct the agreement as a real estate transaction.

- The amount the Airport agreed to pay for the property if Great Plains defaulted was not supported by an appraisal performed in conjunction with the loan. Airport and City officials told us that they did not obtain an appraisal to determine the value of the property prior to entering into the loan agreement. A Great Plains representative indicated in an October 2002 memo that the collateral (i.e., property) might be valued in the \$3 million range. Further, because over 300 acres of the property is leased for another 5 to 20 years, the cost of breaking the leases to use the property for Airport improvements may reduce the fair market value of the property below \$3 million.
- Airport documents show that in February 2002, Great Plains requested an extension to pay its January, February, and March 2002 loan payments. Later, in September 2002, Great Plains, the Airport, and TIA requested that the Bank delay any decision to declare Great Plains in default of its loan. A November 2002 review commissioned by the mayor of Tulsa concluded that Great Plains was at risk of defaulting. Because Great Plains continued to be unable to make its monthly payments, in March 2003 the Bank began using the \$6.75 million escrow account to make the payments. However, the Bank did not declare Great Plains in default.
- On January 23, 2004, Great Plains filed for Chapter 11 bankruptcy. Although it received a 90-day extension to repay the loan, the extension expired on March 21, 2004. Nevertheless, Great Plains still owes about \$7 million of the loan amount (as estimated by City officials), and the Airport is still liable if Great Plains is declared in default of its loan agreement.
- Information presented in three Airport planning documents suggests that the cost of the land acquisition project was inflated after it became apparent that Great Plains might default, given that Great Plains was unable to make its monthly payments in 2002.
 - The Airport’s Five-Year Capital Improvement Plan (CIP) for fiscal years (FYs) 2004 through 2008, approved by the Airport in April 2003, states that the Airport would need to purchase “land adjacent to the airfield which will be needed for the extension of Runway 8/26, Taxiway Charlie, Taxiway Echo and additional Hangar space.” The CIP disclosed that the total estimated cost of the project was \$16.8 million but did not indicate how much land was needed or the acquisition cost of the land.

- A draft version of the CIP that Airport officials provided to us in March 2003 did not mention land acquisition in the narrative description, even though the total cost was also \$16.8 million.
- Finally, a third document, a prior year capital improvement project summary listing for FYs 2002 through 2009, included the project but did not indicate there was a need to acquire land. Also, the cost for the project in this plan was \$10.6 million less than the amount approved in the April 2003 CIP, as is shown in the following table.

Table. Changes in Cost Estimates for the Runway/Taxiway Extension Project

Type of Funds	Project Summary FYs 2002-2009	April 2003 Five-Year CIP FYs 2004-2008	Increase in Costs
Airport Improvement Program (Entitlement)	\$4,200,000	\$ 5,580,000	\$ 1,380,000
Airport Improvement Program (Discretionary)	\$ 0	\$ 3,900,000	\$ 3,900,000
Passenger Facility Charges	\$2,000,000	\$ 7,357,000	\$ 5,357,000
Total	\$6,200,000	\$16,837,000	\$10,637,000
Percentage Increase			172%

Therefore, it appears to us that the CIP costs were increased to justify the collection of PFC funds to purchase the land and to offset the cost of the loan after it became apparent that Great Plains might default. Further, given that correspondence from Great Plains indicated that the collateral (344 acres) might be worth about \$3 million, we question whether the \$9.1 million of PFC funds the Airport requested to pay for the 30 acres represents its fair market value.

- In September 2003, the Airport submitted an application to the FAA to collect and use approximately \$10.2 million in PFC funds to finance the runway and taxiway extension project.⁷ The application included the acquisition of 30 acres of land but did not show the amount budgeted for the land, nor the

⁷ The Airport also anticipated using \$9.5 million of Airport Improvement Program funds for this project.

transactions that had occurred or would need to occur for the Airport to obtain the land. FAA requested that the Airport provide supplemental information to justify this request, including documentation of the amount budgeted for the land acquisition.

- In November 2003, the Airport responded to FAA's request for supplemental information. The Airport indicated that it needed to collect \$9.1 million of its request from PFC funds for the land acquisition. This amount was needed to provide funding to repay \$6.3 million in "Bond Capital" and \$2.8 million in "Interest Expense." (The Airport planned to sell bonds to the public to finance the initial acquisition cost of the land and use PFC funds to repay the bonds and related interest expense when due. This is a normal airport practice and allowable under FAA's PFC procedures.) However, no documentation was attached to indicate the fair market value of the land.
- In December 2003, FAA advised the Airport that it would not approve the land acquisition portion of the project, indicating that "[g]iven the complexity of the land issues," FAA did not have sufficient information to determine if the land acquisition was an eligible PFC project.

As of April 22, 2004, the Bank had not declared Great Plains in default of its loan. Nevertheless, the terms of the support agreement require the Airport to purchase the property for the outstanding balance of the loan. The loan payoff and related fees (estimated by City officials to total about \$7 million) may be significantly higher than the fair market value of the property. We could not determine the true value of the property because, in the records of the transactions we reviewed, we found no appraisal. Airport and City of Tulsa officials advised us that an appraisal was not performed to determine the value of property used as collateral prior to entering into the loan agreement. The only reference to the value of the property was an October 2002, memorandum prepared by a Great Plains Airlines representative indicating that its value "may be in the \$3 million range." According to documentation provided to us by an Airport official, the Airport has until December 2005 to obtain the funds to meet its obligation to purchase the property.

As indicated above, your office has already taken initial steps to require that the Airport properly support requests to use PFC funds. To ensure that the Airport does not inappropriately use PFC funds or any other Airport funds to purchase the property in the future, we recommend that FAA consider the results of this review in any actions it takes in reviewing runway and taxiway expansion projects at the Airport or any future requests by the Airport to acquire all or portions of the 344 acres.

FAA policies and procedures prohibit airports from providing direct subsidies to airlines. In a legal analysis prepared at the request of Airport management on FAA's revenue diversion policy it was noted that:

In light of the current law, regulations and regulatory pronouncements concerning airport requirements for self-sufficiency, the avoidance of revenue diversion, and prohibition against direct subsidy of air carrier operation or service, we are lead [sic] to the conclusion that to avoid regulatory scrutiny, TAIT's support of the Tulsa Industrial Authority - Bank of Oklahoma [BOK] financing for Great Plains Holding Company et al. must be in the nature of a real estate transaction. Even with the transaction structured in that nature, we are not in a position to opine that in the event of a trigger event which would require TAIT action under the Support Agreement, the use of airport revenues to purchase all or a portion of Air Force Plant No. 3 would not be subject to regulatory scrutiny or audit. However, we believe that to the extent the real estate transaction can be narrowed by the size, nature or character of property and/or facilities encumbered by the TIA-BOK transaction, that would dramatically lessen our concern of regulatory review and/or audit of the "support" transaction.

By becoming a party to the real estate transaction to help finance the start-up of the airline and agreeing to pay off any outstanding loan balance, the Airport incurred a contingent liability that will remain until the airline pays the loan in full. However, should the loan be declared in default and the Airport be required to pay off the outstanding loan balance, this action would constitute a direct subsidy to the airline in violation of FAA policy. Further, should the Airport use Airport funds to pay off the loan, it would result in either a diversion of Airport revenue, inappropriate use of PFC funds, or both.

In the event that Great Plains defaults, FAA should take steps to ensure that the Airport does not divert revenues intended for legitimate Airport purposes to pay off the loan. In addition, FAA should evaluate the appropriateness of the Great Plains loan transaction and establish policies that prevent airport sponsors from entering into agreements that could result in the misuse of airport funds.

RECOMMENDATIONS

To ensure that the Airport does not inappropriately use PFC or other Airport funds to purchase the property, we are recommending that FAA require the Airport to:

1. Support any requests for property acquisition with a valid appraisal of the property and require that the appraisal appropriately considers the affect of any leases on the fair market value of the property.
2. Validate that there is a legitimate need to acquire the property to extend the runway and taxiway or to obtain additional hangar space.

In addition, FAA should:

3. Ensure that Airport funds are not inappropriately disbursed to cover the cost of the Great Plains loan.
4. Evaluate the appropriateness of the Great Plains loan transaction and establish policies that will preclude airport sponsors from entering into agreements (similar to the one used to support the Great Plains loan) that create contingent liabilities and place airport funds at risk of being used for purposes not permitted under Federal law.

MANAGEMENT RESPONSE AND ACTION REQUIRED

We briefed Agency officials in June 2003 on the need to closely scrutinize any Airport requests to use Airport funds for purchasing the land used as collateral in TIA's loan to Great Plains. We also provided a discussion draft to FAA in March 2004. FAA management advised us that they have not had an opportunity to review the underlying transactions or documents pertaining to the Great Plains loan; therefore, they could not comment on the appropriateness of the Airport's involvement in the loan transaction. As a result, we have modified our recommendation to address their concerns. FAA agreed with our recommendations to ensure the Airport does not inappropriately use PFCs, or other Airport funds, to purchase the property and our conclusion that Airport funds should not be used to pay off the Great Plains loan. They also agreed to take steps to advise other airports not to enter into agreements, such as the Great Plains loan, that would place airport funds at risk of being used for purposes not permitted by Federal law.

In accordance with Department of Transportation Order 8000.1C, we would appreciate receiving your written comments on this report within 30 calendar days. Please indicate the specific action taken or planned for each recommendation and the target date for completion. You may provide alternative courses of action that you believe would resolve the issues presented in this report.

We appreciate the cooperation and assistance provided by your staff during our review. If you have any questions concerning this report, please call me at

(202) 366-1992 or Mr. David Dobbs, Assistant Inspector General for Aviation Audits, at (202) 366-0500.

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