
Office of Inspector General

**Airport Revenues
Galveston Municipal Airport
Scholes Field, Galveston, Texas**

Federal Aviation Administration

Report Number: AV-1998-011

Date Issued: November 7, 1997





**U.S. Department of
Transportation**

Office of the Secretary
of Transportation

Office of Inspector General

Memorandum

Subject: **ACTION:** Report on Airport Revenues
Galveston Municipal Airport, Scholes Field
Galveston, Texas
Report No. AV-1998-001

Date: November 7, 1997

From: **Alexis M. Stefani** 
Deputy Assistant Inspector General for Aviation

Reply to: JA-10
Attn of:

To: Naomi Saunders
Manager, Airports Division
Southwest Region
Federal Aviation Administration

I am providing this report for your information and use. Your June 6, 1997, comments to our April 8, 1997, draft report were considered in preparing this report. A synopsis of the report follows this memorandum.

The Federal Aviation Administration concurred with all recommendations. Actions taken and planned were reasonable, and are subject to followup requirements of Department of Transportation (DOT) Order 8000.1C. However, please provide estimated completion dates for planned actions as required by DOT Order 8000.1C.

I appreciate the courtesies and cooperation extended to our staff during the audit. Please call me at (202) 366-0500, or Ronald E. Brown at (817) 978-3545, if you have questions concerning this report.

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Airport Revenues
Galveston Municipal Airport, Scholes Field, Galveston, Texas

Federal Aviation Administration

Report No. AV-1998-011

November 7, 1997

Objectives

Our audit objectives were to determine whether (i) the city of Galveston, Texas (city), was in compliance with its Airport Improvement Program grant assurances and (ii) airport-generated revenues were used for the operating and capital cost of the airport. This audit was requested by the Manager, Safety and Standards Branch, Airports Division, Federal Aviation Administration (FAA), Southwest Region.

Results in Brief

The Airport and Airways Improvement Act of 1982, as amended, requires that the airport sponsor agree to comply with assurances as a condition for approval of an FAA grant. Two assurances are Section 511(a)(9), which requires the airport to maintain a fee and rental structure which makes the airport as self-sustaining as possible and Section 511(a)(12), which requires airport-generated revenues be used for the operating and capital cost of the airport.

Galveston Municipal Airport, Scholes Field (airport), is operated by the city. The city is the airport's sponsor. The airport, which currently consists of 966 acres, was transferred to the city in 1950 under the Surplus Property Act of 1944, as amended. For Fiscal Years (FY) 1994 to 1996, the airport earned \$1,561,863 in operating revenues and incurred operating expenses of \$1,676,233 for a net operating loss of \$114,370.

The city was not in compliance with its grant assurances to maintain a fee and rental structure for the airport. We found that city officials had not updated the fee and rental structure since 1983. Consequently, the airport was not as self-sustaining as possible. The city owes the airport \$360,871 for rental fees not charged, lease rates not escalated, and services not provided. We found the city expended airport-generated revenues for the operating and capital cost of the airport, with the exception of about \$1,000.

Monetary Impact

The city owes \$360,871 to the airport.

Recommendations

We recommended FAA notify the city to (i) revise, update, and maintain a fee and rental structure that will make the airport as self-sustaining as possible, to include determining fair market rental value, adjusting rents accordingly, and obtaining FAA approval of the fee and rental structure and (ii) compensate the airport \$360,871 for rental fees not charged, lease rates not escalated, and services not provided.

Management Position

FAA concurred with all recommendations. FAA has requested the city revise, update, and maintain a fee and rental structure to include determining fair market rental value, adjusting rents accordingly, and obtaining FAA approval of the fee and rental structure. FAA has also requested the city to provide them with a payment plan to reimburse the airport for the \$360,871.

Office of Inspector General Comments

Actions taken and planned were reasonable. We have requested FAA to provide us with target dates for completing the recommendations.

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I. INTRODUCTION

This audit was requested by the Manager, Safety and Standards Branch, Airports Division, Federal Aviation Administration (FAA), Southwest Region.

Background

The Airport and Airways Improvement Act of 1982 (AAIA), as amended, requires that the airport sponsor agree to comply with assurances as a condition precedent to approval of an FAA grant. Two assurances are Section 511(a)(9), which requires the airport to maintain a fee and rental structure which makes the airport as self-sustaining as possible, and Section 511(a)(12), which requires airport-generated revenues be used for the operating and capital cost of the airport.

Galveston Municipal Airport, Scholes Field (airport), is operated by the city of Galveston, Texas (city). The city is the airport's sponsor. The airport, which currently consists of 966 acres, was transferred to the city in 1950 under the Surplus Property Act of 1944, as amended. For Fiscal Years (FY) 1994 to 1996¹ the airport earned \$1,561,863 in operating revenues and incurred operating expenses of \$1,676,233, for a net operating loss of \$114,370. The city did not receive a direct Federal grant for the airport in the last 5 years. However, the city received a Federal block grant of \$108,140 from the State of Texas in FY 1993 to design a project to rehabilitate, repair, and mark the runways, taxiways, and apron. The project was designed but never entered the construction phase because the airport was unable to provide the local matching share.

Objectives, Scope, and Methodology

Our audit objectives were to determine whether (i) the city was in compliance with its Airport Improvement Program grant assurances, and (ii) airport-generated revenues were used for the operating and capital cost of the airport.

The audit was conducted from November to December 1996, in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States.

¹At the time of our audit, the city had not issued its General Purpose Financial Statements for the fiscal year ended September 30, 1996. Therefore, we used the FY 1996 Airport Enterprise Fund Preliminary Trial Balance.

The audit was conducted at the FAA Southwest Region, Fort Worth, Texas, and at the city's administration and airport offices, Galveston, Texas. We interviewed officials from FAA Southwest Region Airports Division and the city. At FAA, we reviewed airport compliance and correspondence files. At the city and airport offices, we reviewed 8 lease agreements and compared lease-rate structures for 24 hangers. We reviewed rental charges for airport land and existing buildings, tested airport operating expenditures totaling \$1.2 million and non-operating expenditures totaling \$342,000, determined if the airport maintained a current layout plan, and toured airport property. We also verified proceeds from airport land sales of \$617,000 were properly accounted for and deposited into a restricted cash account to be used for airport purposes.

We evaluated FAA management controls related to monitoring and enforcing AAIA Sections 511(a)(9) and 511(a)(12) assurances, and city management controls related to assessing, collecting, and using airport fees and rents. The management control weaknesses we identified are discussed in Part II and Part III of this report. The audit covered FY 1994 through FY 1996. We also reviewed transactions from earlier periods as appropriate.

Prior Audit Coverage

The Office of Inspector General had not audited accountability and use of airport revenues at the airport within the past 5 years.

II. FINDING AND RECOMMENDATIONS

We found airport-generated revenues were expended for the operating and capital cost of the airport, with the exception of about \$1,000 (see Part III of this report). However, we identified deficiencies with the airport's fee and rental structure.

Finding. Fee and Rental Structure

The city was not in compliance with the grant assurances for fee and rental structure for the airport. We found that city officials had not updated the fee and rental structure since 1983. The outdated fee and rental structure for airport property (i) did not have a basis for the lease rates used, (ii) did not escalate lease rates in compliance with lease agreements, and (iii) permitted airport property to be used without lease agreements and compensation. As a result, the airport was not as self-sustaining as possible.

Lease Rates

Grant Assurance Number 24 states:

It (the sponsor) will maintain a fee and rental structure . . . for the facilities and services being provided the airport users which will make the airport as self-sustaining as possible. . . . (Parenthetical data added.)

FAA Order 5190.6A, Airport Compliance Requirements, states:

FMV (fair market value) for any lease of nonaeronautical revenue production . . . under the Surplus Property Act of 1944, as amended, must be established. Appraisal . . . is one acceptable method of establishing FMV. (Parenthetical data added.)

The city leased airport property with an outdated fee and rental structure. Airport officials did not know the basis for established rates and did not have procedures to establish fair market value. We found:

- The airport did not collect adequate revenues during FY 1996 to cover the expenses of airport hangers. In 1988, the city financed a \$738,515 note for construction of 21 airport hangers under a 20-year lease/purchase agreement. The hangers ranged from 1,230 to 3,240 square feet with monthly lease rates from \$190 to \$500. In FY 1996, the airport made note payments of \$70,631. During the same period, the airport had leased 19 of 21 hangers and collected lease revenue of \$59,619.

- Current tenants of five airport hangers were paying the 1983 rental rate of \$83 per month.
- In April 1994, the airport executed in-kind service agreements with two city departments for a 3-year period. The Municipal Utilities and Public Works Departments used airport property in exchange for providing the airport with services, in lieu of monthly rents of \$1,766 and \$1,291, respectively. We found the city departments did not provide sufficient services to match the value of agreed-upon lease rates. According to airport calculations as of September 30, 1996, the Municipal Utilities Department owed the airport about \$64,000 above the services it provided, while the Public Works Department owed the airport about \$30,000.

Escalation of Lease Rates

The airport did not always adjust rental rates in compliance with escalation clauses in airport lease agreements. FAA Order 5190.6A states:

Where prospective nonaviation tenants plan extensive improvements to leased surplus airport property they will normally seek long-term lease agreements. . . . A fixed rental rate for Federal surplus property may over a period of years become unreasonably less than a fair rental value. FAA should require that leases with a term in excess of 5 years contain a reasonable escalation clause . . . to assure that the land is still producing for the airport the income for which it has a potential.

We reviewed six lease agreements that required escalation clauses. The airport escalated rent on two leases in accordance with lease provisions. Escalation clause thresholds on two lease agreements had not been reached. However, the rent on the city's lease agreement was not properly escalated and one lease agreement did not have the required escalation clause. Details follow:

- In 1989, the city leased airport property for a municipal golf course. The 12-year lease, expiring in 2001, had a base annual rent of \$48,000 to be transferred from the Golf Course Fund to the Airport Fund. The lease payment was to be adjusted annually based on increases or decreases in the consumer price index for the Houston-Galveston area. We found the airport did not adjust the lease payments as required. As a result, as of September 30, 1996, the Golf Course Fund owed the Airport Fund \$54,858 for payments not escalated since FY 1990.
- A current airport tenant leased four tracts of land in 1985 for 40 years with a prepayment of \$108,094. The lease contained no escalation provisions. The

tenant, in turn, subleased one parcel for 40 years with a prepayment of \$50,000. In 1991, the airport rescinded the 1985 lease, paid \$100,000 to purchase three tracts of the airport property, and took over the sublease. The subleased property did not contain lease escalations. The net result of this transaction was that the airport received a total of \$8,094 (\$108,094 - \$100,000) for a 40-year lease. The subleased property currently has a private residence on it.

Use of Airport Property Without Lease Agreements or Compensation

FAA Order 5190.6A states:

The FAA is required to assure itself that surplus land conveyed for aeronautical purposes is so used and that land conveyed for revenue purposes is actually used or available to produce revenue for the continued development, maintenance and operation of the aeronautical facilities.

We found that airport property was used without lease agreements or payments to the airport. Details follow:

- The city Parks and Recreation Department used about 1.1 million square feet of airport property without lease agreements for baseball fields, basketball courts, tennis courts, and playgrounds, all which included permanent improvements. In 1983, the city determined the annual lease value was \$163,350. The city Parks and Recreation Department has not paid rent since 1983.
- The city placed a city sewage treatment facility and water facility on airport property with no executed lease agreement. In 1983, city officials determined the combined annual lease value of the two properties was about \$50,963. In 1996, the city supplied about \$2,300 worth of water and sewage services to the airport as an informal in-kind service. City officials stated the airport was not charged for water as an in-kind service in return for use of the airport property. The city did not compensate the airport for the remaining \$48,663.

We attribute the above conditions to the city's noncompliance with the terms of the grant agreement. City officials did not establish procedures to determine fair market rental value of airport property. During the 3 years ended September 30, 1996, airport revenues from leases and fees were about \$114,370 (\$1,676,233 operating expenses - \$1,561,863 operating revenues) short of covering its operating expenses. Consequently, the airport was not self-sustaining.

Recommendations

We recommend the Manager, Airports Division:

1. Require the city to revise, update, and maintain a fee and rental structure in accordance with FAA Order 5190.6A, to include (i) determining current fair market rental value, (ii) adjusting rents accordingly, and (iii) obtaining FAA approval of the fee and rental structure.
2. Require the city Municipal Utilities Department and Public Works Department to compensate the airport \$64,000 and \$30,000, respectively, for services not provided in lieu of monthly rents.
3. Require the city to compensate the airport \$54,858 for golf course rental payments not escalated in accordance with the rental agreement since FY 1990.
4. Require the city Parks and Recreation Department to execute agreements with the airport for use of property and compensate the airport at least \$163,350 for FY 1996.
5. Require the city Municipal Utilities Department to execute an agreement with the airport for the sewage treatment facility and water facility, and compensate the airport \$48,663 for FY 1996.

Management Response

FAA concurred with all recommendations. FAA has requested the city revise, update, and maintain a fee and rental structure to include determining fair market rental value, adjusting rents accordingly, and to obtain FAA approval of the fee and rental structure. FAA has also requested the city to provide them with a payment plan to reimburse the airport for the \$360,871.

Office of Inspector General Comments

Actions taken and planned were reasonable. However, FAA should provide estimated completion dates for planned actions.

III. OTHER MATTERS

During the audit, we identified additional management control weaknesses that should be brought to your attention.

Garage Rental Charges

The airport was charged \$6,037 during FY 1996 for rental fees on two pieces of city equipment. We questioned city officials about the basis for these charges. The city auditor and a city official evaluated the airport billings and found the airport was overcharged by about \$1,000 during FY 1996. City officials corrected the billing error and returned the funds to the airport account.

Airport Layout Plan

The airport did not have a current Airport Layout Plan (plan). FAA Order 5190.6A requires an airport to have an approved plan depicting the entire property. Grant Assurance Number 29 also requires the sponsor to specifically keep the plan up-to-date at all times. The city last updated the plan in 1992. Since then, airport boundaries have changed through property sales.

Hay on Airport Property

An airport employee hired two individuals, including one city employee, to cut 300 acres of grass on airport property, and to bale the hay for profit. The parties had no formal contractual agreement and no bidding process was used. The Airport Manager told us he had a verbal agreement that 10 percent of sales proceeds would go to the airport. Airport records did not show any proceeds from hay sales.

MAJOR CONTRIBUTORS TO THIS REPORT

These individuals participated in the Audit of Airport Revenues Galveston Municipal Airport, Scholes Field, Galveston, Texas.

Ronald E. Brown	Regional Manager, Region VI
Alvin B. Schenkelberg	Auditor-in-Charge
Kerry R. Barras	Auditor
Gregory E. McLaughlin	Auditor
LaRue Burks	Administrative Support



U.S. Department
of Transportation
**Federal Aviation
Administration**

Memorandum

Subject: **INFORMATION:** Draft Report on Airport
Revenues, Galveston Municipal Airport,
Scholes Field, Galveston, Texas,
Project No. 764-002-6000

Date: JUN 8 1997

From: Manager, Airports Division, ASW-600

Reply to
Attn. of:

To: Mr. Ronald E. Brown
Regional Manager, Region IV
Office of Inspector General

This responds to your April 8, 1997, draft audit report for the audit conducted at Galveston Municipal Airport related to the use of airport revenues at the airport in conformance with Federal Aviation Administration (FAA) grant assurances.

As indicated in the attached May 23, 1997, letter to the city of Galveston, Texas, the FAA fully concurred with the findings and recommendations. The attachment demonstrates the FAA's action to resolve the issues identified by your agency. We will provide follow-up progress reports to you as they occur.

If you have any questions, please contact Mr. Joe Washington at (817) 222-5620.

Naomi L. Saunders

Attachment

cc:
ASW-650

Celebrating 50 Years of Airport Development

MAY 23 1997

The Honorable Henry Freudenburg
Mayor of Galveston
P.O. Box 779
Galveston, TX 77553-0779

Dear Mayor Freudenburg:

We recently received a draft audit report from the Office of Inspector General (OIG) for an audit conducted at Galveston Municipal Airport related to use of airport revenues at the airport in conformance with Federal Aviation Administration (FAA) grant assurances.

The report contains one finding and several recommendations, which we concur with fully. Your assistance in resolving the findings and initiating action(s) on the recommendations, as set forth herein, is requested so that the audit may be resolved.

Finding, Fee and Rental Structure: The city was using an outdated fee and rental structure for the airport. This occurred because city officials had not updated the fee and rental structure since 1983. As a result, the airport was not self-sustaining.

Assurance 24 of the grant agreement, dated August 12, 1991, states that the sponsor will maintain a fee and rental structure for the facilities and services being provided the airport users which will make the airport as self-sustaining as possible.

Additionally, FAA Order 5190.6A, Airport Compliance Requirements, states, "Fair Market Value (FMV) for any lease of nonaeronautical revenue production ... under the Surplus Property Act of 1944, as amended, must be established. Appraisal ... is one acceptable method of establishing FMV."

The audit revealed that the fee and rental structure for airport property (i) did not have a basis for the lease rates used, (ii) did not escalate lease rates in compliance with lease agreements, and (iii) permitted airport property to be used without lease agreements and compensation.

Celebrating 50 Years of Airport Development

1. Lease Rates: The city leased airport property with an outdated fee and rental structure. Airport officials did not know the basis for established rates and did not have procedures to establish FMV.

a. Current tenants of five airport T-hangars were paying the 1983 rental rate of \$83 per month.

b. The airport did not collect adequate revenues during fiscal year (FY) 1996 to cover the expenses of G-hangars. In 1988, the city financed a \$738, 515 note for construction of 21 airport hangars under a 20-year lease/purchase agreement. The hangars ranged from 1,230 to 3,240 square feet with monthly lease rates from \$190 to \$500. In FY 1996, the airport made note payments of \$70, 631. During the same period, the airport leased 19 of 21 hangars and collected lease revenues of \$59,619.

Recommendation for a and b: We request that the city revise, update, and maintain a fee and rental structure in accordance with FAA Order 5190.6A, to include (i) determining current fair market rental value, (ii) adjusting rents accordingly, and (iii) obtaining FAA approval.

c. In April 1994, the airport executed in-kind service agreements with two city departments for a 3-year period. The Municipal Utilities and Public Works Departments used airport property in exchange for providing the airport with services, in lieu of monthly rents of \$1,766 and \$1,291, respectively. The OIG found the city departments did not provide sufficient services to match the value of agreed-upon lease rates. According to airport calculations, as of September 30, 1996, the Municipal Utilities Department owed the airport \$64,000 above the services it provided, while the Public Works Department owed about \$30,000.

Recommendation: We request that the city Municipal Utilities Department and Public Works Department compensate the airport \$64,000 and \$30,000, respectively, for services not provided in lieu of monthly rents.

2. Escalation of Lease Rates: FAA Order 5190.6A, Airport Compliance Requirements, states, "FAA should require that leases with terms in excess of 5 years contain a reasonable escalation clause ... to assure that the land is still producing for the airport the income for which it has potential."

The OIG reviewed six leases with escalation clauses. Five of the leases were held by private parties and one by the city. Escalation thresholds on two leases had not been reached. The airport escalated another two leases in accordance with lease provisions. However, the lease with the city was not properly escalated and one private lease had no escalation clause.

Celebrating 50 Years of Airport Development

a. In 1989, the city leased airport property for a municipal golf course. The 12-year lease, expiring in 2001, had a base annual rent of \$48,000 to be transferred from the Golf Course Fund to the Airport Fund. The lease payment was to be adjusted annually based on increases or decreases in the Consumer Price Index for the Houston-Galveston area. The OIG found the airport did not adjust the lease payments as required. As a result, as of September 30, 1996, the Golf Course Fund owed the Airport Fund \$54,858 for payments not escalated since FY 1990.

Recommendation: We request that the city compensate the airport \$54,858 for golf course rental payments not escalated in accordance with the rental agreement since FY 1990.

3. Use of Airport Property Without Lease Agreements or Compensation: The FAA takes the position that surplus land conveyed for aeronautical purposes is so used and that land conveyed for revenue purposes is actually used or available to produce revenue for the continued development, maintenance, and operation of the aeronautical facilities.

The OIG found that airport property was used without lease agreements or payments to the airport.

a. The city Parks and Recreation Department used about 1.1 million square feet of airport property without lease agreements for baseball fields, basketball courts, tennis courts, and playgrounds, all which included permanent improvements. In 1983, the city determined the annual lease value was \$163,350.

Recommendation: We request that the city Parks and Recreation Department execute agreements with the airport for use of property and compensate the airport at least \$163,350 for FY 1996.

b. The city placed the city sewage treatment facility and water facility on airport property with no executed lease agreement. In 1983, city officials determined the combined annual lease value of the two properties was about \$50,963. In 1996, the city supplied about \$2,300 worth of water and sewage services to the airport as an informal in-kind service. City officials stated the airport was not charged for water as an in-kind service in return for use of the airport property. The city did not compensate the airport for the remaining \$48,663.

Recommendation: We request that the city Municipal Utilities Department execute an agreement with the airport for the sewage treatment facility and water facility, and compensate the airport \$48,663 for FY 1996.

Celebrating 50 Years of Airport Development

Your assistance, and that of other city officials necessary to complete the above action(s) in a timely manner, will be greatly appreciated. We would like to resolve each issue at the earliest date possible; therefore, we request that each of these actions be accomplished and our office notified by June 27, 1997. If all actions are not completed by that date, please submit a status report stating current status and a tentative completion date for each item.

If you have any questions, please contact Mr. Joe Washington at (817) 222-5627.

Sincerely,

Naomi L. Saunders
Manager, Airports Division

cc:
Mr. Carl Shutz
Airport Manager
Galveston Municipal Airport
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ASW-650

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Celebrating 50 Years of Airport Development