

Airport Beacon Report



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LEASE ADJUSTERS

By Michael A. Hodges, MAI, President/CEO

Lease agreements generally fall into one of two categories: those that have fixed rent throughout the term of the lease, and those that periodically adjust. If you are one of those unfortunate airports (or fortunate aviation businesses) that have a fixed-rent lease, then go ahead and skip this article and enjoy your eggnog. However, if your lease does call for an occasional revision, then you might want to read further.

An undeniable fact facing airports and aviation businesses alike is that the cost of doing business continues to grow. Airports continuously strive to keep up with the rising costs of airfield operations and maintenance, while tenants routinely deal with such issues as increasing labor/personnel costs, taxes, insurance, etc. While airport businesses have an opportunity to increase rates and prices to offset some of these costs, airports are typically forced to employ some type of lease adjustment mechanism to keep up these rising costs. The focus of this article is to address just how and when lease adjustments are reasonable and appropriate.

Generally speaking, lease agreements with periodic rent reviews reflect one of three adjustment methods: pre-determined rates or increases; reappraisal/reassessment; or, amendments by changes in the Consumer Price Index or other index.

Pre-Determined Changes

Pre-determined rent adjustments are simply percentage or dollar amount increases that are stipulated to occur at specific intervals during the course of a lease. They are almost always negotiated



Back to Crowded Skies this Holiday Season!

at the time of lease signing, and provide for a level of stability during the term of the lease, as both parties can plan for this revenue/expense over the life of the lease. For an FBO, this is usually the next best thing to having a fixed-rent lease, because it is easy for budgeting purposes.

Reappraisal/Reassessment

Reappraisal or reassessment is another common adjustment method. At specified points during the term of a lease, a new appraisal or market rent analysis is performed on the property, and lease rates are adjusted accordingly. There are certainly numerous benefits to this type of agreement, but there are downsides, as well.

Periodic revaluation allows for a more accurate representation of current market conditions, which is favorable to both the airport and tenant in most circumstances. However, it can also have a negative impact depending upon the point in time it occurs. The aviation industry has certainly experienced its

share ups and downs over the years, and this lease adjustment method may benefit or hurt depending upon where you are in the cycle when it is time to reassess the marketplace. (However, most airports protect themselves by providing that rent can never fall below the level of the previous period.)

Another possible negative to this adjustment technique may be cost. The most important aspects of an appraisal or market rent study are the qualification and experience of the person or company providing the analysis. Extensive marketing analysis and an understanding of the dynamics of the aviation industry are a must. And, of course, using a qualified individual or firm to complete this study costs \$\$\$\$. In many cases, the cost exceeds the potential financial benefits of having such an analysis done. While this may be the case on smaller projects, this method is still probably the most accurate and objective measure of the local, regional, and national aviation market.

Regardless, many airports and/or tenants choose to do an appraisal or market rent analysis anyway, if only to provide a certain “peace of mind” that everyone is being treated fairly. (An important item to remember if a revaluation is done is that only the land improvements that were in place at the time of lease signing are included in the reassessment, unless the lease states otherwise.) However, always look at the long-term cost/benefit analysis of incurring this cost.

The CPI Adjustment

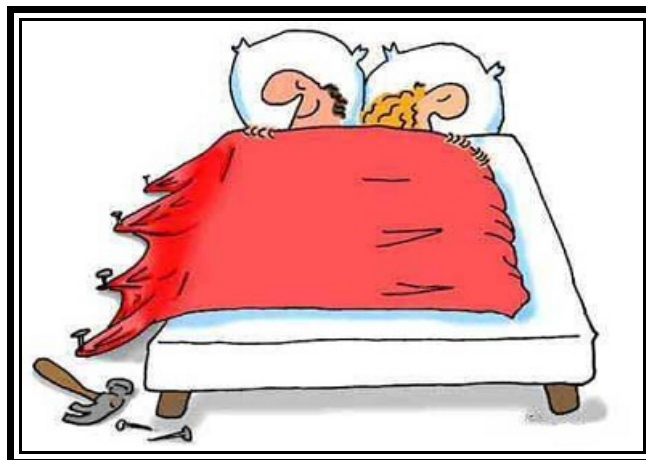
Probably the most common lease adjuster is the Consumer Price Index, more commonly known as the CPI. The CPI is a national (and sometimes local in major metropolitan areas) index which tracks the changes in the cost of goods and services. It is generally based upon trends in retail, wholesale, and manufacturing prices, and is widely accepted as the standard for monitoring the current state of the economy. It is a simple and objective adjustment factor which is readily available to everyone, but unfortunately, it has virtually nothing to do with aviation or real estate. A change in the CPI will

likely have a minimal effect on an FBO’s ability to sell fuel, charter services, aircraft maintenance, or flight training. In fact, a rising cost of living may actually have an opposite impact on an FBO’s business, depending upon their market focus, the type of airport, and the local community.

While the CPI may represent a small piece of a big picture, it should not be the primary focus. Rather, primary influences on the general aviation industry at an airport are operations and retail fuel volumes. Both of these areas represent direct impacts on the financial success or failure of an aviation business, and should be recognized as such. One is not dependent on the other, but they are typically interrelated.

In some corporate GA airports, it is possible to show a decrease in operations, yet an increase in fuel volumes. This would indicate an increase in the number of larger aircraft which burn more fuel. (FBOs love this scenario because it reduces their operating costs per gallon.) To the contrary, a flight training or recreational airport could see an increase in activity, yet stable or decreasing fuel sales. Nonetheless, the most common situation follows the trend that the more planes takeoff and land, the more fuel that is sold.

Because of the dramatic impact of operations and fuel to most aviation businesses, a more appropriate means of lease adjustment might be to tie these two items (or



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possibly others) to the CPI. A “weighted” analysis of these factors will expand the scope of the adjustment approach, but will still represent a relatively simple and objective approach.

In this type of assessment, each of the three (or more) factors is assigned a percentage allocation, based upon its perceived significance in the adjustment process. These percentages are then multiplied against the allocated percentages in the specific category. The resulting percentage factors are then added together to derive the final adjustment factor which will be assessed.

While the determination of the appropriate “weighting” may still leave the door open for negotiations between the airport and tenant, this adjustment method would be more representative of the trends in the local aviation industry, while still recognizing the impact of national economical tendencies.

In the End: Reasonableness and Creativity

As with all other lease-related issues, the common thread has to be fairness and reasonableness. Each side must recognize that the other has a goal and responsibility to maximize returns. The airport must strive to generate sufficient revenues to absorb the costs of maintaining and operating the airfield and its infrastructure, while an aviation business attempt to generate a level of income which allows it to provide acceptable returns to the owners/investors.

Due to these sometimes conflicting goals, it’s important that open lines of communication are maintained. Airports can’t forget that tenants provide a services to that public, and that providing these services comes at a cost. Moreover, general aviation

airports must remember that their success and growth are likely tied directly to the success and growth of their FBO(s). This does not mean that it is the airport’s responsibility to make sure that their FBOs make a certain profit, but rather that everyone has a fair, reasonable, and equitable opportunity to succeed.

Aviation businesses must be reminded that airport management typically answers to a higher authority, which generally is answering to the community and its taxpayers. Thus, creativity often provides the answers that both sides seek. Remember, everyone has a goal to be financially self-sufficient, not just the airport.

Outside the AOA - Opinion Article

By ABS Staff

*(“Outside the AOA” is a new addition to the **Airport Beacon Report**. The opinion article will provide unique and controversial perspectives to issues that affect the industry. During the next year, we guarantee you will not agree with everything you read within this new section.)*

For the past sixteen months, ABS has been providing industry executives the **Airport Beacon Report** each month free of charge. Since the first couple of issues, the Beacon has been very popular among airport executives that are serious about operating an airport that is innovative, creative, and efficient. At each conference, ABS staff hears positive and reassuring comments, and we plan on issuing the newsletter in the future. In addition, each month we receive a number individual requests to be placed on the e-mail distribution list. In fact, it has come to our attention that a number of consulting firms have been attempting to receive copies of our newsletter...which brings us to our point.

The Beacon was developed by ABS to build upon our reputation for being the leader in providing valuation, analysis, and consulting services to airports and aviation businesses. The Beacon was also developed to generate consulting work by discussing issues where we feel that we have become experts. As such, a focus of the newsletter was **not** to educate other



consultants. However, we are flexible with the market and have decided that we would provide the newsletter to other consultants that are not already on the list for a price. After telling airports how to develop additional revenues for years, we have taken it upon ourselves to do the same by providing other consultants a subscription price. Based upon the information provided in a year of the *Airport Beacon Report*, we have decided that a fair consultant's subscription price would be \$100,000 a year. And just think, you have and will continue to receiving it for free.

ASK ABS

In each issue, we have included a section called "Ask ABS", where we request aviation-related questions from our readership. Each month we publish one question that we receive from our readers with a joint reply from our professional consulting team. Even if your question is not selected, all questions submitted will be responded to via e-mail. Please submit a question by e-mailing Mark Davidson at the following: m davidson@airportbusiness.net

This month's question actually came from an FBO (who requested to remain nameless). "My airport manager recently contacted me about possibly charging landing fees at the airport to provide some additional revenue to cover capital projects. I am not sure whether this will impact me or not. What do you think?"

This is a very timely and prevailing issue in the industry, especially at general aviation airports. Creative methods are being explored to generate maximum revenues in this ever-changing segment of the industry. In fact, *AIRPORT BUSINESS* recently devoted an article on this subject relative to Fort Lauderdale.

Many general aviation airports are beginning to look at landing fees again, finally recognizing that unless a user buys fuel from the FBO (except in cases where there is a percentage of gross clause), that there are many users of the airfield that are paying nothing toward the maintenance and operation of the airport.

For this very reason, FBOs began charging service/handling/ramp fees to try to "get something from everyone." There is no reason that airports cannot do the same with landing fees. However, if the goal is to "get something from everyone", then I would suggest having the FBO collect the landing fees, and provide them the ability to waive the fees if a certain volume of fuel is purchased. (The FBO should also be allowed to retain a certain percentage of collections as an administration fee.) Under this "waiver" program, it is imperative that you carefully analyze the volume breakpoints to insure that you are maximizing collection opportunities.

Airport Business Solutions is recognized as the leader in providing valuation, analysis, and consulting services to airports and aviation businesses, and offers a diversity of backgrounds and experience which provides a new, creative, and "outside the box" perspective on a myriad of aviation issues and problems.

In addition, our international affiliate, Airport Business Solutions International, AEC, has helped numerous airports worldwide with a variety of airport management and operational issues and problems. Problems at international airports are no different from those experienced at airports in the U.S., and the diversity of experience and breadth of knowledge of Airport Business Solutions International has been extremely valuable in achieving comprehensive solutions to those issues.

For More Information

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