

Airport Beacon Report



www.airportbusiness.net

July 2006

AIRPORT REVERSION CLAUSES

By Michael A. Hodges, President/CEO and
Mark R. Davidson, A.A.E., Vice President

Most lease documents for long-term ground leases at airports contain a provision known as a “reversion clause”. Reversion clauses basically address what happens to improvements on a leasehold at the end of a lease. (Usually, ownership of improvements made by the tenant revert to the airport sponsor at the end of the lease period.) Essentially, this is the point at which an airport can begin leasing both the land and improvements on a leasehold at their prevailing market rent, as opposed to just receiving ground rent. However, reversion can also take other forms. In some instances, reversion can mean that at the termination of a lease, the Lessor can require that the tenant remove them at their own expense and bring the site back to its original unimproved state.

The presence of a reversion clause is standard within the aviation industry for a number of reasons. These include the provision for future revenue streams, maintaining a certain level of control over the development and maintenance of facilities on the airport, and the ultimate control/management over airport development as it may impact future airport expansion. However, it should be noted that there are numerous other alternatives in place at airports throughout the United States, to include provisions for the airport to purchase the improvements at lease termination. Seldom is there a provision for automatic or perpetual renewals of the lease at the prevailing ground rent only. (Note: Reversion clause are not unique to airports. They are also contained in ground leases on commercial sites in the general real estate market.)



New Economy Class!

Before adopting a leasing policy that addresses reversion, the airport should consider the following issues:

- The reversion policy should be consistently applied to all existing and prospective tenants.
- The airport should take an inventory of the buildings it will be absorbing in the near term and determine if it can cover the cost to bring the improvements up to code.
- Determine if reverted improvements will be attractive to prospective tenants.
- Refer to the airport’s Master Plan to find out if current structures and their locations meet current and future airport development needs.
- Confirm that the reversion policy is in compliance with the Airport’s Sponsor Assurance stated in FAA Order 5190.6.
- Ensure that there is no discrimination between prospective tenants and current tenants whose property has reverted.

In order to determine how airports approach reversion clauses, *ABS* conducted a survey. Of the airports that

responded, two-thirds had reversionary language within their leases, while the remainder had no language at all. The reversionary language varied at each airport, and provided a number of approaches on how the airport sought to protect their interests.

One unique arrangement allows the tenant to choose which type of lease they would like to execute. One lease option was a “buyout lease”, while the other was called a “reversion lease”. If the tenant chose the buyout lease, they must pay a premium rate throughout the term of the lease. At the end of the lease, the airport must purchase the improvements at a price determined by an independent appraiser. The reversion lease was a typical lease in which the improvement reverted to the airport at lease termination.

In addition to the survey, *ABS* contacted the FAA to gain their views on reversion clauses. (Like we really expected a straight answer!) The primary supervisor at one of the Airport District Offices (ADO) advised that the FAA does not track airports with reversion clauses in their leases, and officially does not have a established policy on the issue. (Surprise, surprise!) During the discussion, the supervisor did offer that the FAA recommends reversion clauses to make it clear to the tenant what happens at lease termination, but admitted that their interpretation is that if the lease is silent on the issue, it automatically reverts to the airport since tenants can not own the public land.

To provide additional insight, *ABS* contacted the Branch Manager at the FAA Safety and Standards Office. This Branch had recently worked with an airport dealing with some reversion clause issues. The Branch Manger echoed the ADO Supervisor in stating that the FAA does not have a set policy on reversion clauses. However, he advised that he felt it was a good business practice to include the clause, although problems occur when the clause is included in a lease, but not enforced. (He could just as easily be talking about Minimum Standards, but that is a different article.)

During the course of our research, it was discovered that at one airport, the FAA had to pressure the City

to charge market rates for the “improved land”. As a result, during a review of leases at the airport, it was revealed that the City had renounced or removed its claim to building improvements on several ground leases on the leased airport land, which was in direct conflict with the “reversion terms” of the leases. The Airport inserted new language to the leases that stated that “the City shall not assert any claim to improvements, pre-existing or not.” (Note: This was done at the request of the leaseholders at the airport. Kind of brings to mind the concept of “the inmates running the asylum.”) This did not sit well with the FAA, and now the airport is in jeopardy of losing Federal and State funding, since it is out of compliance with the Grant Assurances.

In a letter to the City from the Department of Transportation, it pointed out that the normal procedure is to rent bare land at a subsidized rate, and to have the improvements revert to the airport after the lease term has expired. These facilities then flow to the airport, who then has the ability to rent the land with improvements at a rate 10 to 20 times greater than the bare ground rental rate. This then allows the airport to become a self-sustaining entity, and lessens the burden on the local taxpayer. The DOT also advised that some of the leases they reviewed were giving away the sponsor’s property interest, which was a direct violation of the law under the anti-donation clause.

On the other side of the issue, the City wrote a letter to the FAA arguing that the reversion clauses could lead to increased City spending. The City stated that asserting that the City should take possession of the improvements may not take into consideration the economic burden the City would be undertaking. In addition to the City, several tenants do not like the reversion since several have sold their interest to third parties for substantial financial gains. (See “inmates running the asylum” above.)

In conclusion, reversion clauses are the “norm” in the aviation industry for a number of reasons. These include maximizing future revenue streams, maintaining a level of control over the development and maintenance of facilities on the airport, and the

ultimate control/management over airport development, as it may impact future airport expansion. Each airport has their own lease language and different approaches to the issue. Regardless, what is best for the airport is the key to developing a consistent policy, and keeping control of your “asylum”.

**BASICS OF SMALL AIRPORT
MANAGEMENT WORKSHOP**

October 14 and 15, 2006

New Orleans, Louisiana

The *Basics of Small Airport Management* workshop is again scheduled to be presented by Michael A. Hodges and Bobbi Thompson in conjunction with the AAAE National Airports Conference scheduled in October in New Orleans. This interaction and informative workshop provides an overview of most property, business, and management issues facing airports today. The workshop is beneficial for those new to the airport management field, as well as those of you with years of experience, and qualifies for 12 CEU credits by AAAE. Contact AAAE to get registered.



ASK ABS

A monthly part of our newsletter is a section called "Ask ABS", where we answer aviation-related questions from our readership. (If we do not receive a question, we make one up.) Each month we publish one question that we receive with a joint reply from our professional consulting team. As stated in our last issue, we would REALLY appreciate more questions from our readers, as we are getting tired of making up questions. Please submit any questions via e-mail to Mark Davidson at: mdavidson@airportbusiness.net

This month's question (it really was an outside question) comes from an Airport Manager in Arizona who asked "*I am curious how many airports are requiring their hangar and tie-down tenants to have liability insurance with the airport owner as additional insured?*"

Let's start by answering this question with a few questions of our own:

- 1) If a fire occurs and spreads to adjacent hangars, who is liable?
- 2) If a tenant is spraying paint and the "overspray" gets on his neighbor's aircraft, who pays for the damage?
- 3) If a tenant has oil on his hangar floor and a visitor falls, who is liable?

Are your tenants willing to assume the financial responsibility of any occurrence with a personal guarantee for the full amount of the loss? (Because that is what they are asking you to do.) Remember, any time there is a risk that is not covered by a tenant, you as the airport sponsor, are liable. (Some call it the "deep pockets" theory.) Are you willing to put your airport at risk? Is the City/County/Commission/Authority willing to accept this risk?

While researching this issue, we talked with a few aviation insurance companies. They indicated that airports are now actually asking for more types and greater levels of coverage's for T-hangar tenants, not less. Costs for insurance vary across the country, but liability insurance naming the airport as an additional insured is reported to be a basic requirement in most T-hangar leases. Some insurance companies contacted report that up to 80% of their public airport clients require this insurance.

While we can empathize with the aircraft operator, the fact is that we live in a litigious society and you as an airport manager have a responsibility to protect a public asset, not to subsidize an individual's flight activities.



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.



An 80 year old woman was arrested for shop lifting. When she went before the judge he asked her, "What did you steal?"

She replied: "A can of peaches".

The judge then asked her how many peaches were in the can.

She replied "6"

The judge then said, "I will give you 6 days in jail."

Before the judge could pronounce the punishment, The husband spoke up and said, "She also stole a can of peas."

For More Information
 Michael A. Hodges, MAI
 President/CEO
 Airport Business Solutions
 10014 N. Dale Mabry Highway, Suite 101
 Tampa, Florida 33618
 Phone (813) 269-2525
 Fax (813) 269-8022
mhodes@airportbusiness.net
www.airportbusiness.net

