Mr. David Bean  
Director of Research and Technical Activities  
Government Accounting Standards Board  

Re: GASB Lease Exposure Draft - Project No. 3-24E

Dear Mr. Bean:

I am a Manager of Financial Planning at the Port of Oakland, responsible for the Port’s annual operating and capital budget, long-range financial planning, debt and funding management and compliance, aviation rates setting, and providing analytical support of the Port’s business development and negotiations. I have registered to participate in the public hearing on June 29, 2016 and below are my questions and comments to the GASB Exposure Draft on Leases, as it relates to Airline-Airport leasing practices.

1. Lack of clarity regarding the purpose of proposed changes to lease accounting for government entities.

When FASB and IASB initiated the changes to the lease accounting standards in 2006, after Enron’s bankruptcy, operating leases were put under a microscope due to concerns about corporate off balance sheet obligations. The credit rating agencies advocated capitalizing operating lease obligations due to a fundamental belief that leasing is simply a form of financing that has a claim on future cash flows of a company. The objective was to make companies’ financial ratios and measures more representative of their ability to meet their obligations and comparable to one another, regardless of how many assets are leased vs. bought and how those leases are classified.

On January 13, 2016, IASB issued a press release on the new IFRS 16, stating : “The new Standard will provide much-needed transparency on companies’ lease assets and liabilities, meaning that off balance sheet lease financing is no longer lurking in the shadows. It will also improve comparability between companies that lease and those that borrow to buy”.1

While the FASB and IASB objective is clear and is likely to be achieved by the proposed changes to the lease accounting, I would argue that capitalization of airline leases on an airport’s balance sheet does not add transparency on airports’ assets and liabilities nor would it improve comparability between airports for the users of their financial statements. In fact, it would result in vastly different financial statements for airports that have an Airline Agreement (for example San Francisco International Airport), vs. those that operate without an agreement, under an ordinance (for example, Oakland International Airport (OAK) and Sacramento International Airport), as well as airports with different rate-making methodologies and lease terms.

---

Airport leases are not financing transaction; their main purpose is cost recovery and airports’ self-sustainability. From the airport’s perspective, entering into a lease with an airline does not equate to a financing transaction. Federal law requires airport operators to provide access to all qualified air carriers on reasonable terms and without unjust discrimination, and prohibits them from granting an exclusive right to operate at their airports. In fact, an airport does not really need to have an airline lease agreement: it is not required by law, nor is it required by the rating agencies or the investment community, who evaluate the airport’s credit based on the strength of the demand in the air traffic market, serviced by the airport, rather than the airlines’ commitment to lease airport space for a period of time.

In the absence of a lease agreement, airports can establish by ordinance, resolution, permit, tariff or other unilateral action the local rules that will govern the use of the airport’s facilities. Importantly, airports are required by the federal government to be as self-sustaining as possible, and receive little or no taxpayer support. This means that airports must fund their operations from their revenue, and diligently plan funding for major infrastructure improvement projects. Ultimately, the airlines and their passengers provide funds to help pay for these long-term projects and sustain airport’s operations.

2. Questions and comments related to capitalization rules.

Depending on the type of the rate-making methodology, the airlines that signed an Airline Agreement (Signatory Airlines) at an airport are committed to pay all the annual residual (i.e. net of non-airline revenues) costs of operating this airport (fully residual agreement); or annual residual direct and indirect costs of terminal and airfield cost centers (cost center residual agreement); or annual residual direct and indirect costs of the airfield cost center and a portion of the terminal costs, based on the ratio of space they occupy to total leasable space (compensatory agreement). While the airlines are committed to pay these costs, the actual costs over the life of the lease are not known. Airports would usually develop rates and charges projections over the lease term but the actual rates can vary significantly from these projections. Airports also usually reserve the right to adjust rates and charges throughout the fiscal year, if needed for cost recovery purposes and/or to meet bond covenants. Since airline leasing rates over the lease term are not fixed but are based on annual budgets, how would an airport reasonably determine the lease receivable and deferred inflow of resources? Using long-term rates and charges projections, which can change every year during the planning cycle, would require frequent re-measurement of the lease receivable, which would create an administrative burden without any apparent benefits.

Another complexity lies in the fact that these commitments will be paid by the airlines both via their fixed rent payments, based on the space they occupy, and variable payments based on their activity (passengers, bags, landed weight, etc.). However, regardless of how these costs are invoiced, collectively, the Signatory Airlines guarantee that they will pay the total. Since Signatory Airlines are committed to pay all future known and unknown costs, billed as either fixed or variable rents, would an airport include the variable payments in the capitalized assets and liabilities?

With or without a lease agreement, airline rates and charges (i.e. leasing rates) are established annually based on the airport budget developed in the planning process. Typically, airline rates are set based on budgeted direct and indirect operating expenses, debt service payments, past capital cost reimbursements (asset depreciation or amortization), and required reserves. Throughout a fiscal year,
airports track their operating and capital expenditures and debt service payments in direct (such as terminal, airfield, ground transportation, cargo, etc.) and indirect cost centers (such as planning, police, aircraft rescue and firefighting, administration) and after the fiscal year close, perform a reconciliation of the actual vs. budgeted costs that determines the surpluses or deficits due to/from the airlines. Depending on the airport’s settlement process, these surpluses/deficits are either billed or reimbursed to the airlines or included in next year’s rates and charges. How would these surpluses/deficits be treated under the new accounting rules in each case?

3. Capitalization of airline lease revenues would result in capitalization of airport operating expenses, and double capitalization of debt obligations and capital assets.

Capitalizing the airline lease revenues would in essence equate to capitalization of the airport’s projected net operating expenses (including personnel, maintenance, security, aircraft rescue and firefighting, general and administrative costs, etc. and sometimes partially offset by non-airline terminal revenues), debt service payments (including principal, interest and sometimes debt service coverage), asset depreciation and amortization, required reserves and other costs based on the applied ratemaking methodology over the term of the airline lease. This would result in recording on the balance sheet airports’ expectations of their future operating costs that are recoverable from the airlines and reimbursements of debt service and capital costs that are already recorded on the balance sheet. If the trigger for recording additional assets and liabilities is an Airline Agreement, then there will be significant differences in the financial statement of airports with and without an Airline Agreement without any underlying economic reason, as the absence of an Airline Agreement does not impact airports’ financial viability, ability to charge cost recovery rates, and finance long-term multi-million projects.

To summarize, in my opinion, it is unclear from a financial statement analysis perspective, what is the purpose and value for requiring airports to capitalize airline leases by booking lease receivables and deferred inflow. Recording such additional assets and liabilities is unlikely to provide an investor or a member of the public with useful information for evaluating financial position of an airport. It would actually diminish comparability of airport balance sheets and income statements, as their assets, liabilities and interest income would be quite different depending on rate-making methodologies, lease terms, discount rates, or in the absence of airline agreement. At the same time, it will result in significant administrative burden for airport accounting staff to record and regularly re-measure these balance sheet entries.

I greatly appreciate the opportunity to provide my comments and questions and will participate in the public hearing on June 29, 2016 in person. Meanwhile, I can be reached at (510) 627-1752 or my email tstarostina@portoakland.com.

Best regards,

Tatiana Starostina