

Airport Reversionary Rights “Yours today, Mine tomorrow”

PRESENTER

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This Could Be You

→ Camarillo and Oxnard, CA

- “Owners of the airplane hangars at the Camarillo and Oxnard airports have hired a law firm to help them lobby *county officials to change the terms of a proposed lease agreement that would allow the county to take ownership of the hangars*”

source: VC Star 6/12/2018

This Could Be You

→ Chico Pilots and Businesses

- “Chico Airport Commission meetings are generally attended by a handful, but contention was countable as pilots and business owners filled the room for nearly four hours this week to oppose *the city’s move to add reversionary clauses to leases*”

source: Chico-Enterprise Record 3/10/2018

This Could Be You

→ Coeur d'Alene

- “In a standing-room-only meeting Wednesday night, the Coeur d'Alene Airport Advisory Board got an earful of public feedback on the proposal to overhaul rules and regulations. *A major issue is the draft reversion clause. It would give privately-funded hangars to the county airport upon the expiration of their leases”*

source: Coeur d'Alene/Post Falls Press 6/14/2018

This Could Be You

→ Shreveport Downtown Airport

- “The real battle could come over hangars...People who lease land and own hangars have a reversion clause written into their 15-year leases...That clause gives the airport ownership of the hangar at the end of the lease”
- *The reversionary clauses were never enforced*

source: Shreveport Times 5/24/2018

FAA Airport Compliance Inspection

- FAA's Compliance Inspection of Shreveport Downtown Airport
 - "...the sponsor's **failure to exercise reversion** clauses in leases has contributed to **forfeiting their rights and powers** (SA5) as well as their ability to **move closer to self-sustainability.**"(SA24)
 - "The sponsor **does not have a mechanism** in place to **assume title** (exercise reversion clause) of the hangar at the termination of the lease."

source: FAA letter to Shreveport Airport 5/24/2018

FAA Airport Compliance Inspection

→ FAA's Compliance Inspection of Shreveport Downtown Airport

- Every lease included a reversion clause
- Unknowns:
 - Does reversion occur at end of term
 - Does reversion occur at end of negotiated lease extension
 - Airport failed to exercise their 'reversion' clause contained in the lease agreement

Reversionary Clauses In Lease Agreements

→ Issues with Reversionary Clauses

➤ Usually seen as two “flavors”:

(1) airport failed to require them (or enforce them) and loses control of the property,

(2) tenants do not want them because it degrades “their entitled property rights at the airport,” which is an erroneous assumption

Reversionary Clauses In Airport Leases

→ First and foremost...

- FAA does not regulate airport leases, it only establishes the framework (size of the “sand box”) provided by the applicable statutes, grant assurances, obligations in property conveyances, and policies
- Federally obligated airport property is, by definition, “encumbered” from day one, **There is no expectation for a user to acquire permanent rights**

Reversionary Clauses In Airport Leases

→ First and foremost...

- There is no entitlement beyond those permitted under the airport's federal obligations
- The leasing of airport property comes with restrictions, which should be reflected in the leases the airport executes
- When airport property is leased, the **airport sponsor** has the leased fee interest, while the **tenant** maintains the leasehold interest

Reversionary Clauses In Airport Leases

→ Is it a new concept?

- Reversion or reversionary rights is not a new concept
- Commonly used in real property transactions (real estate), particularly during lease arrangements
- They have been common in US civil aviation (airport management) since well before WWII.
- Not an unreasonable term and condition for land leases within the context of federal obligations (i.e., GA 22).

Reversionary Clauses In Airport Leases

→ Is it a new concept?

- Reversion is an industry practice, even a best practice, common in hangar leases (private & corporate), FBO leases, MRO/Cargo facilities, airline terminals, airline gates, and airport management lease/agreements
- Reinforces the sponsor's ability to retain control of the property, its improvements, and adequately manage planning, future development/needs, safety, revenue generation, compliance, environmental, and other functions

Reversionary Clauses In Airport Leases

→ Is it a taking?

- A reversionary right is not a taking. Takings law does not apply to the adoption or implementation of consensual contract provisions by a government acting in its proprietary capacity
- An airport's execution of a lease of airport property is proprietary in nature, especially within the context of its federal obligations. Accordingly, remedies generally arise from the contracts themselves, rather than from the protection of private property rights

Reversionary Rights

→ What is Reversion?

- Upon expiration of the term of a lease, the ownership of the permanent improvements made by the lessee (tenant) reverts to the lessor (airport sponsor) or improvements must be demolished or removed at lessee's cost.

Lessee Rights

→ Lessee Rights

- Although the lessee would have the right to possess the property during the duration of the property lease, these rights are neither permanent nor exclusive thereafter
- Acquiring control of the remaining structure is part of the benefit to the airport and can be worked into the lease terms
- In some cases, and as part of the lease terms, the airport sponsor can purchase back any remaining residual value in the structure

Federal Interest

→ Federal Interest

- If lease term is too long or if the airport ‘surrenders’ its ability to change that use of the property by entitling continuing use, the airport’s “rights and powers” are weakened if not eliminated, undermining the federal interest therein
- *Reversion is the airport sponsor’s ability to control development and use of airport property through perpetuity*

FAA Sponsor Assurances

→ Assurance 4 – Sponsor Must Maintain Good Title

- An airport may have given away so much in a lease (or other agreement) that it no longer has “free and clear” title to the property (49 USC 47106(b)(1) and Grant Assurance 4)

FAA Sponsor Assurances

→ Assurance 5 – Preserving Rights and Powers

- Airport will not sell, lease or encumber, or otherwise transfer or dispose of any part of its title or interests in the “Exhibit A” without prior approval from the FAA
- Subordination clause
- *Failure to include or exercise lease agreement reversionary clauses contributes to eliminating the sponsor’s rights and powers*

FAA Sponsor Assurances

→ Assurance 22 – Economic Nondiscrimination

- 22(a) – No unjust discrimination and reasonable access for aeronautical users
- Grant Assurance 22 applies since reversionary clauses are a reasonable term and condition in airport leases. Airport through FAA Assurances retain all authority through (contracts and agreements) to operate the airport
- Such as variable lease terms based on level of investment by the lessee is an industry practice (leasing policy)

FAA Sponsor Assurances

- Assurance 24 – Rent and Fee Structure
 - Fair Market Value (FMV) is the standard
 - Any discrimination must be justified
 - Reasonable distinctions among users OK
 - Value of services
 - Financial self-sustainability
 - Airports must maintain a fee and rental structure that makes the airport as financially self-sustaining as possible
 - The purpose of the self-sustaining rule is to maintain the utility of the federal investment



FAA Sponsor Assurances

→ Assurance 24 – Airport Self-Sustainability

→ Reversion of improvements at the end of a lease allows an airport to:

- Acquire improved facilities as agreed to in a lease
- Provides a continuing revenue stream
- Maintains a clear title after lease end
- When reversion occurs, rental rates transition from ground lease rates to facility lease rates, thus generating more revenue for the airport
- Failure to include or exercise lease agreement reversion clauses impacts the sponsors ability to achieve or maintain financial self-sustainability



FAA 5190.6B Compliance Manual

- Options to acquire title are unacceptable
 - (Order 5190.6B ¶ 6.3(b))
- Reversion Provision (Term)
 - Lease term must be reasonably necessary to amortize tenant's investment (Order 5190.6B ¶ 12.3(b)(3))
- Reversion Provision (Title)
 - Title to improvements must vest in sponsor at lease end (Order 5190.6B ¶ 12.3(b)(5))



Federal Aviation
Administration



Centennial Airport (APA) 1994



Centennial Airport (APA) 2004





Centennial Airport (APA) 2014





Centennial Airport (APA) 2024?



Issues Related to Reversion

- Permanent vs. Non-Permanent Improvements
- Commercial vs. Non-Commercial Entities
- Assignments and Transfers



Permanent vs. Non-Permanent Improvements

→ Permanent Improvements

- Built as a complete facility (i.e. floor/footing, structure, ramp, parking lot, etc.)
- Building permit and certificate of occupancy
- Lease term based on investment
 - Enough time to amortize and depreciate investment (improvements) by lessee
- Reversion of improvements recommended

Permanent vs. Non-Permanent Improvements

→ Non-Permanent Improvements

➤ Portable Hangars

- (e.g., Port-A-Port Hangars, Portable T-Hangars, etc.)

➤ What is a Non-Permanent Hangar?

- Hangar is placed on existing pavement
- Easy to move, tow and/or remove
- Usually does not require a building permit or certificate of occupancy

➤ Lease/License term usually month-to-month, year-to-year

➤ Removal of non-permanent improvements recommended

➤ Reversion of leasehold (land-lease) recommended

Permanent vs. Non-Permanent Improvements

- Reversion of permanent improvements (lease structure and rental rate will change)
 - Prior to reversion: lessee pays a “ground” lease rental rate based on use (i.e. commercial or non-commercial and improved or unimproved)
 - After reversion: permanent improvement, the lessee pays an “improved” rental rate based on the use commercial or non-commercial) and type (i.e., hangar, office, shop, storage, etc.)

Commercial vs. Non-Commercial

→ Commercial vs. Non-Commercial Entity

➤ Commercial

- Depreciate the investment (improvements) for tax purposes

➤ Non-Commercial

- Unable to depreciate investment (improvements) for tax purposes

➤ Leasing Policy: account for both commercial and non-commercial entities (all aeronautical lease agreements should include reversionary language)

Assignments and Transfers

→ Lease Assignment/Transfer

- Reversion during an assignment/transfer of a lease term:
 - Option 1: **Lease as is** (no term or rental change)
 - Option 2: **Lease w/term extension** (no rental change)
 - Option 3: **Lease w/term extension consistent with industry best practices** (reversion deferral fee)
- Request to defer reversion of improvements
 - Capital investment
 - Projected loss of revenue
 - Establish reversion deferral fee

Assignments and Transfers

→ Reversion Deferral Fee

- Charged by an airport sponsor to defer reversion of tenant improvements and continue a land rental rate
- A reversion deferral fee is an **identification of the value** of the leasehold **beyond the original term** (or date of reversion)
- A reversion deferral fee is **composed of several elements**:
 - Projected **rental rate** at the **time of the reversion date** (“improved rate”)
 - Projected **rental rate** (post reversion date) **adjusted over remaining term** of the lease
- When should an airport sponsor implement a reversion deferral fee?
 - When an existing lease agreement is extended beyond the original term during an assignment

Managing Reversionary Rights

- **Develop a lease management strategy**
 - Know status of each lease improvement
 - Prepare tenants long in advance for reversion
 - Watch for deliberate damage to improvements
 - No exceptions for convenience, friendship, loyalty
 - Appraise FMV (not depreciated value) at lease end
 - Reset lease rate (market rate)
 - Educate - What is reversion? (purpose and value of reversion)

Managing Reversionary Rights

- **Develop a lease management strategy**
 - Develop a leasing policy
 - PE or other building professional ('standard of condition assessment') every 3-5 years
 - Reversion obligations
 - Expiration of lease term and reversion language
 - Identification of the improvements that will revert to the airport sponsor at the end of lease term
 - Notification of reversion to sublessees

Managing Reversionary Rights

- Potential political fallout from reversion of leasehold facilities
 - Develop talking points be proactive not reactive
 - Ensure the policymakers understand the issue
 - Create a single point of contact within the organization
 - Be consistent and compelling with the message
 - Reversion implementation plan

This Could Be You

→ Chico Pilots and Businesses

- “Chico Airport Commission meetings are generally attended by a handful, but contention was countable as pilots and business owners filled the room for nearly four hours this week *to oppose the city’s move to add reversionary clauses to leases*”
- Chico Airport Outcome:
 - Negotiate new lease (with reversion language)
 - Existing tenant may remove their property (i.e. hangar)
 - Existing tenant may leave property to airport (reversion)

Reversionary Lease Language

→ New Lease Language

Ownership of Improvements.

Title to all improvements, including the Hangar, to be constructed on the Premises by Lessee shall be owned by Lessee until expiration of thirty (30) years from the commencement date of this Lease or earlier termination of this Lease. All improvements, including the Hangar, on the Premises at the expiration of the term or earlier termination of this Lease shall, without compensation to Lessee, then automatically and without any act of Lessee or any third party become City's property. Lessee shall surrender the improvements to City at the expiration of the term or earlier termination of this Lease, free and clear of all liens and encumbrances, other than those, if any, permitted under this Lease or otherwise created or consented to by City. Lessee agrees to execute, acknowledge, and deliver to City any instrument requested by City as necessary in City's opinion to perfect City's right, title, and interest to the improvements and the Premises.

Lessee shall have the right to remove such personal property, machinery, and equipment as may be removed without threat to the structural integrity of any building or improvement. If damage results from the removal of any such items, Lessee shall repair such damage at its sole expense.

Source: City of Redding, California

Concluding Thoughts

- Ignoring reversion can have far-reaching ramifications that will adversely impact
 - Airport's finances
 - Compliance with federal law, and
 - Tenant relationships

Thank You!

“Any Easy Questions?”



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