Dealing with Reversionary Rights

PRESENTER
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Association of California Airports
2018 Annual Conference

South Lake Tahoe, California
September 13, 2018
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- **37 years** of aviation experience
  - Airport Manager/Executive Director
    - Santa Monica Airport (**SMO**)
    - Reno Stead Airport (**RTS**)
    - Hawthorne Municipal Airport (**HHR**)
  - Aviation management consulting (airports and aviation businesses)

- Commercial/CFI pilot’s license with an instrument rating
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- Certified Member of AAAE
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Presentation Outline

- Introduction
- Overview of Reversionary Rights
- FAA Perspective on Reversion
- Issues Related to Reversion
- Managing Reversionary Rights
- Dealing with the Politics
- Case Study
- Open Discussion
Hangar Battle Brewing

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.

Talk of reversion irks Chico pilots, 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.
Turbulence Ahead

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.

**FAA audit uncovers decades of mismanagement at 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.
What is “Reversion”?

- Upon expiration of the term of an agreement, the ownership of the permanent improvements made by the lessee revert to the lessor (airport sponsor), usually at the lessor’s option.
  - In the alternative, the airport sponsor may require the lessee to demolish or remove improvements and return the leased premises to its original condition.

- Reversion is not limited to the value and/or type of improvements.
  - All lease rights and privileges granted to lessee revert to lessor.
Overview of Reversionary Rights

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

- If improved by the airport sponsor, the lessee typically pays for preferential or exclusive use of supporting improvements
  - vehicle parking, apron, etc.
Overview of Reversionary Rights

Reversion relates to the airport sponsor’s control over the development and use of airport property through perpetuity

Reversion provides:
- a means to acquire improved facilities
- a robust future revenue stream
- ensures financial self-sustainability
- ensures control over leasehold O&M requirements

Revert or not to revert – that is the question....
Applicable Airport Sponsor Assurances

- Assurance 5, Preserving Rights and Powers
- Assurance 22, Economic Non-Discrimination
- Assurance 24, Fee and Rental Structure
The airport sponsor “… will not take or permit any action which would operate to deprive it of any of the rights and powers necessary to perform any or all of the terms, conditions, and assurances…”

and will act promptly to acquire, extinguish or modify any outstanding rights or claims of right of others which would interfere with such performance…”
Assurance 5, Preserving Rights and Powers

Based on the FAA’s interpretation of Assurance 5a as it relates to reversionary interests, an airport sponsor’s failure to include or exercise lease agreement reversion clauses contributes to forfeiting the sponsor’s rights and powers.
Assurance 22, Economic Nondiscrimination

- Sponsor will make its airport available as an airport for public use on reasonable terms and without unjust discrimination to all types, kinds, and classes of aeronautical use.

- Each commercial aeronautical activity (operator) shall be subject to the same rates, fees, rentals, and other charges as are uniformly applicable to all other such operators making the same or similar uses of the airport and utilizing the same or similar facilities.
Assurance 24, Fee and Rental Structure

“... [airport sponsor] will maintain a fee and rental structure for the facilities and services at the airport which will make the airport as self-sustaining as possible under the circumstances existing at the particular airport, taking into account such factors as the volume of traffic and economy of collection.”
Assurance 24, Fee and Rental Structure

- Based on the FAA’s interpretation of Assurance 24 as it relates to reversionary interests, an airport sponsor’s failure to include or exercise reversion clauses in an airport lease agreement impacts the sponsor’s ability to achieve or maintain self-sustainability.
…the sponsor's failure to exercise reversion clauses in leases has contributed to forfeiting their rights and powers as well as their ability to move closer to self-sustainability.

The sponsor does not have a mechanism in place to assume title (exercise reversion clause) of the hangar at the termination of the lease.
Even though **all leases have a reversion clause**, the specifics of reversion whether at the term end of the lease or at the end of negotiated lease period extensions was unknown.

The airport has **never exercised** this portion of the lease agreement.

The FAA stated that “Current airport sponsor management practices **do not appear to meet the obligatory requirements** for a federally obligated airport and **could impact future grant funding**”.

The sponsor must submit corrective action plans for FAA approval.
Issues Related to Reversion

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

Permanent Improvements

- Typically built as a complete facility (i.e. floor/footing, structure, ramp, parking lot, etc.).
- Requires a building permit and certificate of occupancy.
- Lease term based on investment:
  - Sufficient time to amortize and depreciate investment in the lessee-developed improvements.
- Reversion of improvements recommended.
Permanent vs Non-Permanent Improvements

Non-Permanent Improvements

- Typically *portable hangars*
  - (e.g., Port-A-Port Hangars, Portable T-Hangars, etc.)
- What constitutes a *non-permanent hangar*?
  - Hangar is *placed on existing pavement*
  - *Easy to move/tow to a new location*
  - Typically *do not require a building permit or certificate of occupancy*
- Lease/licence term typically *month-to-month, year-to-year*
- Reversion of ownership not recommended
- Reversion of leasehold (land-lease) *recommended*
Commercial / Non-Commercial Entity

- **Non-Commercial**
  - Unable to depreciate improvements, for tax purposes
  - What constitutes “value” at end of term?

- **Commercial**
  - Able to depreciate the investment, for tax purposes

Beware of an unintended consequences of a leasing policy whereby it is **more advantageous for a non-commercial entity to construct a hangar (with no reversion) vs. a commercial entity (who has reversion).**

Strive for parity to level the playing field
Assignments and Transfers

Lease Assignment/Transfer

- Addressing reversion during a transfer/assignment 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)

- Addressing request to defer reversion of improvements.
  - Capital investment
  - Projected loss of revenue
A reversion deferral fee is charged by an airport sponsor to defer reversion of tenant improvements and continue on a land rental rate only basis.

- 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
Managing Reversionary Rights

Develop a process for tracking and exercising reversionary rights
- Throughout the lease term
- Within 3-5 years of lease termination
- Within 1 year of lease termination
- Prior to, and upon, termination of lease

Foster an effective and positive lessor-lessee relationship related to reversion

Develop a proactive approach to reversion

Communicate – Communicate – Communicate!
Principles used to ensure tenant improvements are well maintained

- Lease agreement should include a 'standard of condition assessment' report throughout the term of the lease
  - Every 3-5 years (professional engineer or building inspector)
- Regular facility maintenance should be integrated into lease agreement and becomes obligation of Lessee
  - Repair and maintenance records required as part of condition assessment
  - Applies to the entire leasehold – i.e. airside and landside infrastructure, pavement, landscaping, etc.
Managing Reversionary Rights

- Throughout the term of the lease – airport sponsor routinely provide annual notices to tenants
  - updated certificate of insurance
  - rental rate adjustment information

- Reversion obligations should be included in these communication:
  - Expiration of lease term
  - Reversion language - emphasizing obligations
  - 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

Within 3 – 5 Years of Lease Termination: clearly state the intentions of the airport sponsor:

- will **entertain negotiating a new lease** agreement at the new “improved” rental rate.
- will **assume the improved leasehold** and all rights and privileges granted to lessee
- will **commence an RFP process** for the leasehold premises
- will **require lessee to demolish or remove improvements** and return the leased premises to its original condition
Managing Reversionary Rights

Within 1 Year of Lease Termination: clearly restate the intentions of the airport sponsor:

- will require lessee to conduct a detailed inspection of leasehold improvements and provide a condition report
- will require correction of all deficiencies
- will require copies of all records related to maintenance/repair activities, or
- will require a detailed demolition plan
- will require lessee to submit a detailed summary of leasehold vacation action plan (if applicable)
Managing Reversionary Rights

Prior to, and upon, termination of lease

- Establish a standing weekly meeting at least one-month prior to termination date
- Review leasehold vacation action plan
- Review salient lease requirements
- Emphasize ramifications of non-compliance
- Closely monitor close-out of lessee’s operation
- Establish several walk-through dates
- Establish final inspection date
Managing Reversionary Rights

Develop a strategy to keep management informed

- Get buy-in at the very top of the organization
- Get on the same page - stay on the same page

Develop a strategy to keep policymakers informed

- Clearly explain what lessee(s) is involved, what reversion is, why it is in the best interest of the sponsor to exercise reversionary rights, and ramifications related to not exercising reversion.
- Tell them why and then tell them again (and again)

Communicate – Communicate – Communicate!
Managing Reversionary Rights

Dealing with deferred reversion

- Identify and **define the scope and scale of the issue**
  - Is it **just one lessee** or multiple lessees?
  - **How long** has it been going on?
  - **Underlying issues?**
  - **Understand the politics** involved (if any)

- Develop a corrective action plan
  - **Develop a leasing policy** that addresses reversion
  - **Get buy-in** at the top of the organization

- **Meet with affected tenant(s)** – be transparent – be open
Dealing with potential political fallout from reversion of leasehold facilities

- Develop talking points for the press well in advance – 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
Concluding Thoughts

Reversion of leasehold improvements can be a very contentious issue if not handled in a prudent and proactive manner.

Ignoring reversion can have far-reaching ramifications that will adversely impact:

- The airport’s finances
- Compliance with federal law, and
- Tenant relationships
Case Study:

- Chico Municipal Airport
- Open discussion
Questions and Answers

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Thank You!
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