



U.S. Department
of Transportation
**Federal Aviation
Administration**

Western-Pacific Region
Airports Division

P. O. Box 92007
Los Angeles, CA 90009-2007

May 15, 2014

Morgan Scott
Development Services Operations Manager
City of Cottonwood
1001 Mingus Avenue
Cottonwood, AZ 86326

Dear Mr. Scott:

**Cottonwood Municipal Airport (P52)
Land Use Inspection Report**

This letter is in regard to the Federal Aviation Administration (FAA) inspection of Cottonwood Municipal Airport (P52) on May 21 and 22, 2013. It provides the findings and recommendations of the FAA land-use inspection. First, we wish to thank you for the assistance and cooperation that you provided during the inspection. We also wish to recognize the additional time and attention that you and other city officials provided by responding to additional requests for information after the visit.

Background

Airport inspections serve as a means for the FAA to perform surveillance of federally obligated airports in order to assess whether or not airports are complying with federal requirements. General aviation airport inspections are part of a national program that is being undertaken pursuant to Senate Report No. 106-55, dated May 1999. Congress directed that the FAA conduct land-use inspections at airports that have received federal assistance in order to detect and correct inappropriate or unapproved land uses. In addition, the FAA must provide Congress with a report of the results of the inspections and the FAA's plans to correct inappropriate land uses.

Inspection

During our inspection, we examined airport leases and toured the airport to assess the current uses of airport land and facilities. We also toured the industrial park. We found that airfield operation land uses generally complied with federal requirements. However, the land side areas of the airport contained lease and land-use arrangements that did not fully comply with the Grant Assurances.

The findings of the inspection, the relevant federal standards, and follow-up recommendations are described in the remainder of the report.

History of Airport Development

On August 12, 1968, Yavapai County conveyed Cottonwood-Clemenceau Airport to the Town of Cottonwood. The airport subsequently became known as Cottonwood Municipal Airport.

In 1983, the Town of Cottonwood (later a City) entered into a lease agreement with Cottonwood Airpark, Inc., which effectively gave the tenant control of the airport for a period of 100 years. Based on the provisions of the original lease, the build-out of the tenant improvements were scheduled to be completed by 2009.

The rent for unimproved land was set at a fixed amount per acre per year. Based on the agreement, the current rate would be \$125 per acre per year for unimproved land. However, the tenant was given a rent credit to be applied to the unimproved ground rent for the amount of expenses the tenant incurred making improvements to the leasehold property. The rent credit had the effect of lowering the rental rate. When land was improved and subleased, the rental rate converted to .01¢ per square foot and no further unimproved ground rent had to be paid.

Other generous lease provisions included the following: The tenant could collateralize airport property with a lender for the benefit of a construction loan. The Town surrendered its right of condemnation, carried the tenant as a named insured, gave the tenant the option to assume an "airport services" agreement, agreed to seek tenant's approval before making any changes to the airport, and promised to seek financial assistance to improve the airport as a benefit to the tenant.

In 1985, the "landing strip area" (runway) had to be removed from the lease agreement so it would become a non-exclusive, common use area that was accessible by public aviation users. Without this change, the runway would not have been eligible for FAA Airport Improvement Program Grants since the original lease made it the exclusive property of the tenant.

In 1989, a lease agreement amendment provided for the tenant to release a small plot of land to the City for the construction of an effluent pond (2.95 acres), as well as the granting of easements for appurtenances connecting to the pond (.03 acres). As compensation, the City agreed to pay for the construction of a 12-inch water line that would serve the tenant's property and waived the tenant's obligation to share in the cost of the pipeline.

In 1993, a lease agreement amendment provided for the tenant to release a small plot of land to the City for the construction of a terminal building (.77 acres). As compensation, the City agreed to waive the requirement that the tenant pay ground rent for the plot as stipulated in the original lease agreement.

In 1994, a lease agreement amendment provided for the tenant to release 30.046 acres of land to the City. The release area contained prime aeronautical airport property, namely, ramp and taxiway, as well as a long and narrow undeveloped strip of land west of the

runway and taxiway. As compensation, the City agreed to grant the tenant a \$24,000 rent credit that could be applied by the tenant to future rent due.

In 1997, lease assignments were initiated whereby the original tenant's rights under the 1983 lease agreement were assigned to new lease holders for plots of land that had been developed. Some assignments contained undeveloped land that still had to be developed by the new tenant. For the most part, the assignments transferred the original lease to the new tenants with only minor changes. Consequently, the newer tenants have essentially the same lease agreement as the original tenant was given in 1983.

In 2002, the City negotiated a 50-year lease with the Yavapai County Community College District for .87 acres at the nominal cost of \$1 per year, with no provision for a rent adjustment over the full term of the lease.

In 2006, the City negotiated a 35-year lease with the Verde Valley Humane Society for 4.0602 acres at the nominal cost of \$1 per year, with no provision for a rent adjustment over the full term of the lease.

The Public Works Department occupies airport property without any written agreement, for which it does not provide tangible compensation to the airport.

Inspection Findings

Among the non-conforming conditions found were the following:

The airport was transferred to a private developer in 1983 to promote economic development from non-aviation uses, although the airport was already contractually obligated by agreements with the Federal Government to serve as an airport. This was done under the terms of a 100-year lease agreement and without the prior review and approval of the FAA. Effectively, the entire airport was leased, including the airfield, to one tenant. There were subsequent amendments and assignments to the original agreement. None improved the terms of the original agreement, brought the lease in conformity with changing conditions, or increased the financial return for the City of Cottonwood (City).

Although fair market value (FMV) should be the pricing standard that is used to set rates for the non-aviation rental of airport land, P52's airport rental rates for its non-aviation tenants likely do not represent FMV and may even be well below it. In some cases, the City is effectively providing free rent. There is no evidence that an appraisal was ever done to estimate land values and guide City leasing decisions.

The leases do not contain provisions to adjust the rent to maintain parity with inflation and market conditions. Therefore, if the rental rates were below FMV, they will remain below FMV indefinitely. While the cost of operating and maintaining the airport will continue to increase, the rental revenue to pay for it will not.

Changing conditions cause government bodies to establish new or revised legal ordinances and policy standards, such as hazardous materials restrictions, insurance requirements,

zoning rules, and changes in rates and fees. In spite of multiple lease assignments, the original lease provisions have not been materially revised to eliminate outdated or inappropriate provisions or to add new provisions to incorporate legal requirements established since 1983.

Lastly, significant changes were made to airport land uses that were not correctly reflected on the ALP and that were not approved by the FAA before they were implemented by the City.

Applicable Federal Law and FAA Policy

Federal law authorizes programs for providing federal funds and other assistance to local communities for the development of airport facilities. In exchange for assistance, airport sponsors assume certain obligations, either by contract or by restrictive covenants in property deeds, to maintain and operate their airport facilities safely and efficiently and in accordance with specified conditions. Commitments assumed by airport sponsors in property conveyance or grant agreements are important factors in maintaining a high degree of safety and efficiency in airport design, construction, operation and maintenance, as well as ensuring the public fair and reasonable access to the airport for aeronautical purposes.

The following is a disclosure meant to explain the Airport Improvement Program, Airport Sponsor Assurances, the FAA Airport Compliance Program, and the enforcement of Airport Sponsor Assurances.

The Airport Improvement Program and Grant Assurances

Title 49 U.S.C. § 47101, *et seq.*, provides for federal airport financial assistance for the development of public-use airports under the Airport Improvement Program (AIP). Upon acceptance of an AIP grant, the assurances become a binding contractual obligation between the airport sponsor and the federal government that govern the way the airport should be operated. The FAA has a statutory mandate to ensure that airport owners comply with these sponsor assurances. FAA Order 5190.6B, *FAA Airport Compliance Manual* (Order), issued on September 30, 2009, provides the policies and procedures to be followed by the FAA in carrying out its legislatively mandated functions related to compliance with federal obligations of airport sponsors. The *Policy and Procedures Concerning the Use of Airport Revenue* (64FR7696, February 16, 1999) provides guidance for interpreting the requirements of Assurances 24, *Fee and Rental Structure*, and 25, *Airport Revenue*, that are related to the ways airports earn money and spend money.

The FAA's airport compliance efforts are based on the contractual obligations an airport owner accepts when receiving federal grant funds or the transfer of federal property for airport purposes. Pursuant to 49 U.S.C. § 47122, the FAA has a statutory mandate to ensure that airport owners comply with the federal grant assurances. The FAA considers it inappropriate to provide federal assistance for improvements to airports where the benefits of such improvements will not be fully realized due to non-compliance with the grant assurances.

The FAA Compliance Program is designed to achieve voluntary compliance with federal obligations accepted by owners of public-use airports developed with FAA-administered assistance. Therefore, in addressing allegations of noncompliance, the FAA will make a determination as to whether an airport sponsor is *currently* in compliance with the applicable federal obligations and seek cooperation and correction when the sponsor is not in compliance.

Certain FAA grant assurances apply to the circumstances set forth in this Report: Grant Assurance 5, *Preserving Rights and Powers*; Grant Assurance 19, *Operation and Maintenance*; Grant Assurance 22, *Economic Nondiscrimination*; Grant Assurance 23, *Exclusive Rights*; Grant Assurance 24, *Fee and Rental Structure* and Grant Assurance 29, *Airport Layout Plan*.

Grant Assurance 5, *Preserving Rights and Powers*

Grant Assurance 5, *Preserving Rights and Powers*, requires the airport owner or sponsor to retain all rights and powers necessary to ensure the continued operation of the airport consistent with its federal obligations. This assurance implements the provisions of 49 U.S.C. § 47107(a), et seq., and requires, in pertinent part, that the owner or sponsor of a federally obligated airport "...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 assurances in the grant agreement without the written approval of the Secretary, and will act promptly to acquire, extinguish or modify any outstanding rights or claims of right that would interfere with such performance by the sponsor."

Grant Assurance 19, *Operation and Maintenance*

Grant Assurance 19, *Operation and Maintenance*, requires the owner of an airport developed with federal assistance to operate and maintain a safe airport at all times. The owner will not permit any activity that would interfere with the airport purpose of the facility. Grant Assurance 19 deals with safety and implements the provisions of 49 U.S.C. § 47107(a)(7) and requires that the airport and its facilities be operated and maintained in a safe manner and for airport purposes.

Grant Assurance 22, *Economic Nondiscrimination*

Grant Assurance 22, *Economic Nondiscrimination*, implements the provisions of 49 U.S.C. § 47107(a)(1) through (6), and requires, in pertinent part, that the owner of any airport developed with federal grant assistance will operate the airport for the use and benefit of the public and to make it available to all types, kinds, and classes of aeronautical activities on fair and reasonable terms and without unjust discrimination. Grant Assurance 22 deals with both the reasonableness of airport access and the prohibition of adopting unjustly discriminatory conditions as an obstacle to limit access.

Grant Assurance 23, *Exclusive Rights*

Grant Assurance 23, *Exclusive Rights*, implements the provisions of 49 U.S.C. §40103(e) and 47107(a)(4), and requires, in pertinent part, that the owner or sponsor of a federally obligated airport: will not, either directly or indirectly, grant or permit any person, firm, or corporation, the exclusive right at the airport to conduct any aeronautical activities and will terminate any exclusive right to conduct an aeronautical activity before the grant of any assistance under Title 49 United States Code.

Grant Assurance 24, *Fee and Rental Structure*

Grant Assurance 24, *Fee and Rental Structure*, requires the owner of an airport developed with federal assistance to make the airport as self-sustaining as possible. Grant Assurance 24 implements the provisions of 49 U.S.C. § 47107(a)(13) and requires that the airport owner maintain a schedule of charges for use of facilities and services at the airport that will make the airport as self-sustaining as possible under the circumstances existing at the airport, including volume of traffic and economy of collection. It also requires the airport owner to undertake reasonable efforts when entering into new and revised agreements establishing rates, charges, and fees to make the airport as self-sustaining as possible under the circumstances existing at the airport.

Grant Assurance 29, *Airport Layout Plan*

Grant Assurance 29, *Airport Layout Plan*, implements provisions of 49 U.S.C. § 47107(a)(16) and requires, in pertinent part, that the sponsor of a federally obligated airport will keep the airport layout plan up to date at all times showing (1) the boundaries of the airport and all proposed additions thereto, (2) the location and nature of all existing and proposed airport facilities and structures (3) the location of all existing and proposed nonaviation areas and of all existing improvements thereon; and (4) all proposed and existing access points used to taxi aircraft across the airport's property boundary. The sponsor will not make or permit any changes or alterations in the airport or any of its facilities which are not in conformity with the airport layout plan.

Analysis

The following is an explanation of the inspection findings in the context of the relevant grant assurances:

Master Lease Agreement Issues

In 1983, the City entered into a 100-year lease agreement with Cottonwood Airpark, Inc. that effectively turned over the entire airport to the tenant. The purpose of the agreement was to promote economic development and employment opportunities. The agreement did not require the tenant to foster and promote aeronautical use and development, although the City was already legally obligated by agreements with the federal government to operate the airport for that very purpose. The agreement also gave the tenant a right to execute an

Airport Operator Agreement to bring the airfield under the tenant's control, which subsequently did occur.

The following shortcomings resulted from the agreement:

Assurance #5: The City compromised its proprietary rights and powers when it leased the airport and subordinated its authority over the airport to that of the tenant, and thereby encumbered its ability to manage and operate the airport in compliance with the grant assurances. The City further encumbered its ownership rights by granting a 100-year lease, which is tantamount to a fee simple transfer.

FAA Order 5190.6B contains policy guidance that FAA employees use to evaluate compliance with the grant assurances. In accordance with FAA policy, airport sponsors should not enter into lease agreements in excess of 50 years, especially when the sponsor cannot control the long-term planning and development of the airport and loses the ability to manage the airport's fiscal strategy that would help make the airport as self-sustaining as possible.

Assurance #19: The lease promoted economic development by allowing non-aviation uses of the airport. As a result, non-aeronautical development replaced the intended purpose of the airport and deterred the growth of aeronautical activities. This was done without seeking and receiving approval from the FAA before any non-aviation uses were introduced.

Assurance #22: Based on this assurance, the airport must be available for all types and classes of aeronautical activities on reasonable terms and without unjust discrimination. The City prevented itself from complying with this requirement because the lease gave the tenant an exclusive right to control and limit access to the airport as well as to focus on non-aeronautical over aeronautical development.

Assurance #23: Although the granting of an exclusive right is prohibited, the City, nonetheless, granted control of the airport under a comprehensive exclusive right arrangement with the tenant. Expanding the exclusive right, the City pledged its fee title interest in the airport to the tenant as security for a loan from a lender. In addition, the City pledged other concessions to the tenant (i) by making the tenant an additional insured under the City's airport insurance policies, (ii) by pledging not to exercise its powers of condemnation over any of the leasehold property, and (iii) by seeking the tenant's consent before making any changes to airport facilities or services.

Consequences of the tenant's exclusive right powers manifested themselves in unexpected, and sometimes costly, ways. In 1985, the tenant was asked and agreed to make the "landing strip" (runway and taxiway) available for public use in order for the City to remain eligible for FAA grants. The tenant agreed to the change without compensation because it was beneficial to make the federal government entirely responsible for runway and taxiway improvements, while the tenant still maintained exclusive control of the airport.

In 1989, the City requested that the tenant release approximately 3.01 acres for an effluent pond and easements. As compensation for this concession by the tenant, the City agreed to

construct and maintain a 12-inch water pipeline that would serve the tenant and to waive any requirement for reimbursement of the tenant's share of the construction costs.

In 1993, the City requested that the tenant release approximately .77 acres for the construction of a new terminal building. As compensation, the City agreed to reduce the tenant's ground rent and grant a development credit for the amount of the released land.

In 1994, the City requested another release for approximately 30.046 acres representing the airport operating area that included the hangar area, ramp, and undeveloped strip of land along the taxiway. As compensation for this concession, the City agreed to compensate the tenant by granting a \$24,000 rent credit and a development credit equal to 10 acres of developed property.

In 1997, assignments of the master lease by the original tenant to new tenants began and continued until 2007 when Cottonwood Airpark, LLC was dissolved. Subsequently, the new tenants have made assignments of their leases. All the assignments basically transferred the terms and conditions of the original lease with only minor changes to new tenants. The changes did not fully eliminate the shortcomings of the original lease.

Rates and Charges Issues

The 1983 lease contained terms that were very favorable for the tenant, including the rental rates. At the time, the City's motivation was to promote local economic development and employment. However, the City did not ensure that the airport itself would receive a financial return that maintained parity with inflation and market conditions. The rental rate remains the same for the entire term of the lease agreement and is not subject to upward adjustments. The rate could be lowered or waived, which has been done from time to time. When lease assignments were executed, they were approved with the same terms and conditions as the original lease. The newer leases contain the same flaws as the original lease. There has been no attempt to update or enhance the leases to reflect new legal standards, policy changes, or the realities of the market place.

This shortcoming is especially pronounced with the non-aeronautical leases. Assurance #24 requires that the airport rates and charges be established to make the airport as self-sustaining as possible. The *Policy and Procedures Concerning the Use of Airport Revenue* (64FR7696, February 16, 1999) further clarifies the requirements of Assurance 24. The policy stipulates that non-aeronautical uses of airport property must be subject to rental charges that are based on fair market value. Airport sponsors may not use airport property for non-aeronautical purposes without paying market rent. The original lease was executed in 1983 and does not provide any provision for rent increases. Therefore, the rental rate cannot keep pace with market conditions and inflation. Furthermore, the lease assignments contain the same provisions and rates as the original. Consequently, the lease rates will never be on a par with market value, may never have been, and will continue to fall behind market value during the remaining years of the 100-year term of the lease.

Assurance #24 has been augmented by United States Code 47107(l)(3) that directs airport sponsors to undertake reasonable efforts to make the airport as self-sustaining as possible

when entering into new or revised agreements. Basically, the original lease agreement at P52 is underperforming when it comes to making the airport as self-sustaining as possible. The opportunity to revise and update the original lease presented itself when lease assignments were requested and before they were approved. Unfortunately, this was not done.

More recently, the City entered into additional non-aeronautical leases. Unfortunately, these newer leases are not capable of making the airport as self-sustaining as possible. A 50-year lease with Yavapai County Community College District was executed in 2002. The rental rate is \$1 per year without any provision for an increase during the entire term of the lease. Another lease with the Verde Valley Humane Society has a term of 35 years and imposes a \$1 a year rent during the entire term of the lease with no increase. Lastly, the City Public Works Department occupies airport property without any interdepartmental agreement to provide any compensation to the airport. As with the Cottonwood Airpark master lease and all the assignments, these three non-aeronautical leases do not comply with Assurance #24.

When we requested information from the City regarding rent collection amounts and leasehold property dimensions, the information was not readily available. City staff took a long time to provide the information. We do not know if the repository of information was not complete or not organized for easy retrieval. As a result, we were given the impression that the City may not know how much rent it should be collecting and if the full amount due is being paid on schedule. This shortcoming, if it exists, would represent a vulnerability with the internal controls of the financial system. Furthermore, it could be preventing the airport from earning all the revenue that it is due.

Airport Planning Issues

Over the decades, changes were made to the airport that were not always reflected on the Airport Layout Plan (ALP), as required by Assurance #29. These changes involved mostly non-aeronautical development. The changes were made without the prior review and approval of the FAA. Today, the ALP does depict non-aeronautical uses on the east side of the airport. However, the west side is not yet accurately depicted. The triangular parcel of land north of Mingus Avenue is not clearly labeled non-aeronautical although occupied by a school, animal shelter, and public works. The large parcel where the effluent pond is located is labelled for aeronautical and non-aeronautical development. We determined that this area is presently leased under a lease assignment from the original tenant. Therefore, the City does not have the power to direct development of this area or even adjust the rent once it is developed. It is not clear for what purpose the land will be used since the lease does not specify. As a result, the ALP states, "Future aeronautical/non-aeronautical development area." With unrestricted options, the tenant can develop the airport property without much regard for the airport as long as it conforms to local zoning.

Summary and Conclusion

Assurance #5

All the non-aeronautical lease agreements continue to prevent the City from fully complying with the grant assurances. Lease rental rates are below market value and agreements do not

contain provisions that would easily allow the City to raise rates. Current tenants who received undeveloped land by lease assignment have continuing obligations to develop the property, but it appears they are not undertaking timely development of the leased property. Furthermore, these leases do not mandate that any undeveloped land be developed for aeronautical purposes. **These shortcomings continue to exist and require attention.**

Assurance #19 and #22

The airport should be available for all kinds and classes of aeronautical activities. Land uses that prevent aeronautical activities should either not be allowed or should be approved by the FAA before they are allowed. Although large areas of the airport have been permanently changed to non-aeronautical use, undeveloped areas should be subject to review and approval before they are designated for non-aeronautical uses. To be in compliance with these assurances, the City should consult with the FAA before converting more land to non-aeronautical uses.

Assurance #23

Cottonwood Airpark, Inc. was given an exclusive right with the execution of the original lease and exercised it for many years. The improprieties of the exclusive right have dissipated with the passage of time and the assignments of the original lease to multiple new non-aeronautical tenants. An improper exclusive right does not presently exist. Therefore, this shortcoming has been eliminated over time by changing circumstances.

Assurance #24

The rental rates for all the non-aeronautical tenants are likely well below the market. They are the largest group of airport tenants. Therefore, the City is not realizing all the revenue it would be earning if the rental rates were closer to or equal to market value. **This shortcoming continues to exist today and requires attention.**

Assurance #29

As the assurance stipulates, the City will keep the ALP up to date at all times, showing the location and nature of all existing and proposed airport facilities and structures and the location of all existing and proposed non-aviation areas and of all existing improvements. The City will not make changes or alterations in the airport that are not in conformity with the ALP. **This is a shortcoming today and requires attention to ensure the ALP is accurate.**

Follow-Up

We request that the City develop a corrective action strategy to address the shortcomings described in this report. The strategy should include, but not be limited to, plans that address the following issues and questions.

1. How will the City correct the following shortcomings identified in the Report?
 - Confirm if the City is collecting the proper amount of rent from all airport tenants, that is, are tenants paying the proper amount of rent and paying it when due?

- Determine fair market value based on an appraisal, that is, has an appraisal ever been done, and if not, when will one be done?
 - Require fair market value rent from new non-aeronautical tenants and users, that is, base future rental rates on market conditions and an appraisal.
 - Require as a condition of any new lease assignment or request for lease amendments that the lease agreement be updated to include new rental rates, an escalator provision, and local land use ordinances that are not in the old lease.
 - Persuade existing non-aeronautical tenants to increase rental payments, that is, determine if there is some equitable way to adjust rental rates in the future.
 - Prevent new unsuitable non-aeronautical activities, that is, only consider airport compatible non-aeronautical projects where non-aeronautical use presently exists.
 - Seek FAA approval before implementing any new non-aeronautical use, that is, consult with the FAA before converting unused airport land into a non-aeronautical use.
 - Determine when tenants will develop undeveloped leasehold property and seek a commitment from them for its development for those lease agreements that still contain an obligation to develop the leased land.
2. Please send us your corrective action strategy to allow us to evaluate whether it sufficiently addresses the shortcomings identified in this report in order that they be mitigated or eliminated altogether.
 3. Please estimate how long the strategy will take to implement and accomplish.

Please provide the City's reply with the proposed corrective action strategy and implementation schedule **within 60 days** of receipt of this letter. We believe that two months will allow you to share this report with City officials and the City Council in order to agree on a response.

Please mail the reply to:

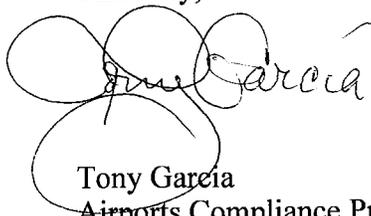
Tony Garcia
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In closing, please be advised that Section 722 of Public Law 106-181 (April 5, 2000) amended 49 USC 47131 and requires, as part of the DOT Secretary's annual report to

Congress, the inclusion of a detailed statement listing airports that the FAA believes are not in compliance with grant assurances or other requirements with respect to airport land use. The report includes a description of the non-compliance issues, the timeliness of corrective actions by the airports, and the actions the FAA intends to take to bring the airport sponsors into compliance. With the City's cooperation, we shall be able to report that the City is correcting its non-conforming land uses. Conversely, without cooperation, the FAA would have to take these shortcomings into account when evaluating the award of grant assistance.

We look forward to your response. If you have any questions or wish to discuss this matter, please call me at (310) 725-3634.

Sincerely,

A handwritten signature in black ink, appearing to read "Tony Garcia". The signature is written in a cursive style with large, overlapping loops.

Tony Garcia
Airports Compliance Program Manager