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Subject: **Lunken Airport – Revenue Audit**

Attached is the Lunken Airport report. This performance audit examined and evaluated the contract and lease management and operations at the Airport. We have completed the report in accordance with Internal Audit's (IA) Fiscal Year 2013 and 2014 Audit Work Plan.

If you need any further information please contact me.

Attachment

Lunken Airport Revenue

August, 2013



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Executive Summary

Internal Audit (IA) performed a revenue audit of Lunken Airport, in accordance with the Fiscal Year 2013 and 2014 Audit Work Plan. The audit objectives were to review the contracts associated with the operations of the Airport and to ensure that the City of Cincinnati (City) was receiving revenue as required by the lease contracts.

IA began this review of operations with the objective of ensuring revenues from the Sky Galley Restaurant were being paid properly to the City through the Aviation Division (Aviation) of the Department of Transportation and Engineering (T&E). IA discovered irregularities between the lease and the Municipal Code and expanded the audit. These irregularities amounted to more than \$100,000 in a three year period.

Per best practices, Aviation charges a landing fee to transient aircraft based on the licensed standard gross weight of the aircraft. IA found that the fees charged are higher than the fee schedule set in the Municipal Code. The fees collected in the month of May, 2013 were approximately 40% higher than what the Code specifies. There was also a period of time where the fees went uncollected, entirely.

Municipal Code section 402-23 requires that all commercial operations located on Airport property pay one percent of their gross revenues, every six months. IA was informed that some entities have not paid the required fees, or submitted the required paperwork. In addition, IA found that the Metropolitan Sewer District (MSD) has a Memorandum of Understanding for Airport land used to store the byproducts of their treatment processes. MSD has not paid 6 years worth of rent.

Many of the issues that IA found were related to property management and communication between departments. Due to the nature of airports, Aviation is removed from much of City activity and the resulting isolation hampers the effectiveness and efficiency of the Division. Having a position dedicated to property management would allow the Airport Manager to facilitate communication between departments and streamline efforts to improve efficiency at Lunken Airport.

I. Introduction

Background

Lunken Airport was established in 1925 and formally dedicated in 1930 as the largest municipal airport in the world. Lunken has seen a number of historic events, such as Charles Lindbergh landing on his way to and from his historic trans-Atlantic flight, the founding of the Embry-Riddle Company and American Airlines. Lunken Airport was the main airport of the Cincinnati region until flooding proved it to be unreliable for long-term use. The Cincinnati/Northern Kentucky International Airport took this role when it opened for commercial traffic in 1947.

Tenants at Lunken Airport mostly consist of corporate partners, charter operations, small private aircraft, car rentals, and operations catering to the aforementioned. Landmark is currently the only operating large scale Fixed-Base Operator (FBO), providing a large range of services to other tenants at the airport, including repairs, charter flights, and fueling services. Landmark purchased the previous FBOs in 2011.

In 2012, the Aviation Division recorded more than \$2,000,000 in revenue. These revenues are derived from a number of sources, many of which are codified in the City of Cincinnati Municipal Code (Section 402). Among these codified sources are fuel revenues, ground rent from operators, landing fees for non-Lunken based aircraft, and a fee for all airport related revenue generated by for-profit companies.

Audit Selection

This audit was conducted in accordance with the Fiscal Year 2013 and 2014 Audit Work Plan.

Audit Objectives

The primary objectives of this audit were to review the contracts associated with the operations of the Airport and to ensure the City is receiving revenue as required by the lease contracts and the Municipal Code.

Audit Scope and Methodology

This audit encompassed revenue generating entities on the grounds of Lunken Airport. Initially, the scope was limited to the Sky Galley Restaurant, but after discrepancies were discovered, the scope was broadened to all of the rent-paying entities on Airport grounds with a focus on lease management and oversight.

IA analyzed financial and operational data; interviewed key staff members; and reviewed pertinent documents, regulations, and policies.

Scope Limitations

The scope was limited by the lack of information from some businesses located on the airport grounds. Landmark, the Fixed-Base-Operator, has not provided statements of revenue since they purchased the business in 2011.

Statement of Auditing Standards

As required by Administrative Code Article II, Section 15 this audit was conducted in accordance with the Generally Accepted Government Auditing Standards (GAGAS), except for standard 3.96 pertaining to external peer review requirements. These exceptions did not have a material effect on the audit. Audit fieldwork was conducted between April and June, 2013.

II. Audit Findings and Recommendations

The Fees in the Sky Galley Restaurant Lease are set much lower than the Municipal Code.

The Sky Galley is a restaurant occupying a portion of the Lunken Airport Administration Building, operated by Brakvill, Inc. The lease defines the space as 3,308 square feet of the first floor and 386 feet of the basement. Section 402-25 of the Municipal Code specifies that there are two components to the monthly fee for this space, one based on square footage, and one based on gross revenue. It reads as follows:

Restaurant and Refreshment Space: The minimum rental rate shall be \$9.00 per square foot per year, plus \$2.50 per square foot per year for the appurtenant basement space, payable monthly in advance, plus the monthly payment of a minimum of 4.75 percent of the gross income received during each month from the operation of the restaurant and refreshment business in such space which income exceeds the monthly charge for the occupancy based on the above annual square foot rates.

The lease, entered into March 6, 2007, specifies a different rate schedule, which results in significantly less rental income for Aviation. First, the lease requires a monthly payment of \$1,500 in base rent. By doing the required calculations using the square footage from the lease, and the square foot price specified in the Municipal Code, IA determined the total due is \$2,561.41, monthly. The difference in these two rates adds up to a discrepancy of \$1,061.42 per month.

The lease also stipulates that Brakvill pay a total of 3% of gross revenue each month, as opposed to the rate set by Municipal Code (4.75%). The difference of 1.75% between the two documents leads to a significant difference in revenue to Aviation. IA reviewed the monthly statements from January, 2010 to February, 2013 and found that for the three year period, Sky Galley had paid nearly \$67,000 less for their gross revenue, than they would have under the standards of the Municipal Code.

In total, IA found that Brakvill would have paid \$105,402.69¹ more over the 3 year time period had they been held to the statutorily required payment structure.

Further, during the review of payments, IA noted that Brakvill, Inc. was making payments based on a net revenue calculation of their own, which resulted in lower payments to Aviation than the lease requires. These discrepancies were significantly smaller than the ones previously mentioned, resulting in a loss of approximately \$2,700.

Recommendation 1: Aviation should conduct reviews of the payments made by Brakvill, Inc. to ensure that they are paying the required amount every month.

Recommendation 2: Aviation should work with the Law Department to ensure that leases and the Municipal Code are in agreement.

¹ [C-9 Comparing Lease Rates to Minimum Rates Set by Municipal Code 402-25](#)

Landing fees are charged using a different rate schedule than set in the Municipal Code and went uncollected.

Section 402-24 of the Municipal Code specifies the landing fees for itinerant aircraft using Lunken Airport. These fees are broken out by weight and engine type.

Gross Takeoff Weight (in lbs)	Piston	Turbo Prop	Jet
Multi-Engine up to 5,999	\$ 4.55	N/A	N/A
6,000 to 7,999	\$ 5.20	\$ 5.85	N/A
8,000 to 9,999	\$ 5.85	\$ 6.50	N/A
10,000 to 11,999	\$ 6.50	\$ 7.15	N/A
12,000 to 14,999	\$ 7.80	\$ 8.45	\$ 10.40
15,000 to 17,999	\$ 8.45	\$ 9.10	\$ 11.70
18,000 to 25,999	\$ 9.10	\$ 9.75	\$ 13.00
26,000 to 33,999	\$ 9.75	\$ 10.40	\$ 14.30
34,000 to 41,999	\$ 10.40	\$ 11.05	\$ 15.60
42,000 to 49,999	\$ 14.30	\$ 17.55	\$ 20.80
50,000 to 65,999	\$ 20.80	\$ 24.05	\$ 26.00
66,000 to 74,999	\$ 27.30	\$ 30.55	\$ 33.80
75,000 and over	\$ 33.80	\$ 37.05	\$ 39.00

Aviation charges flights at a \$1 per 1,000 lbs (over 5,000 lbs) per landing at Lunken Airport. This alternative fee schedule results in overcharging in a number of instances, sometimes nearly double the amount specified in the Municipal Code. Using information from this database, IA was able to match each flight for May, 2013 with the appropriate engine category. IA then calculated the charges as set by municipal code and compared them with the charges under the current system. IA determined that flights landing at Lunken Airport were charged approximately \$4,200 extra, out of a total of \$9,901 collected in that month.

Currently, Aviation contracts with Bruel-Kjaer to provide tracking services for flights landing at the Airport. Flights are identified by their tail number and matched with information filed with the FAA and that data is then available to Aviation personnel in a database. Aviation staff stated that due to problems with a former system for tracking flights in and out of the airport, landing fees were uncollected for an unspecified period of time, possibly “a couple of years.” Using \$5,000 as the typical landing fee revenue collected in one month, two years of uncollected fees would total \$120,000.

Recommendation 3: Aviation should ensure that landing fees are paid at the correct amount and work to ensure that any systems utilized for payments reflect required amounts.

Recommendation 4: Landing fees should be collected for any time that they are due.

Leases have expired.

As Lunken currently has no commercial air service, the airfield is surrounded by corporate hangars, charter flight companies, private owners, and companies built around serving their needs. The land is owned by the airport and leased to the tenants who either use City owned hangars, or build their own – which revert to City ownership after a specified time. Many of these leases are long term (25 to 30 years) or have extension features that make them, for all intents and purposes, the same. These leases have built in payment escalators, but when a lease is ending and needs to be renegotiated, it is a chance to ensure fair market value for the City owned properties.

IA found that many of these leases come to an end and revert to a month-to-month period before they are renegotiated. This allows for some flexibility with planning for Aviation, but it reflects lost revenue in terms of increased rates.

Recommendation 5: Aviation should renegotiate contracts before they expire if a tenant wishes to renew, or find a new tenant as quickly as possible.

Recommendation 6: A property management position should be created to aid in the maintenance and development of leases for the airport. This is a specialized position and should have appropriate knowledge of airport operations and needs.

Municipal Code requires 1% fee of gross revenue from tenants.

Municipal Code Section 402-23 requires any person operating a service for the sale of fuel, charter flight service, rental of aircraft, maintenance services etc, pay an operating fee to the City, “the sum of one percent of gross revenue received from operations.” Later, it requires that every operator should submit a sworn statement from a certified public accountant showing their gross revenues over each six-month period of operations (January to June, and July to December). Failure to pay can result in the penalty of ten percent (10%) of the fee. IA could not determine when the last update to this percentage took place.

Recommendation 7: Aviation should research and determine if the 1% of gross revenue is appropriate and has kept pace with current airport practices.

Landmark has not paid required 1% of gross revenue.

In 2011 Landmark purchased the rights to be the Fixed-Base Operator (FBO) at Lunken Airport. The operations of two previous FBOs were purchased and turned over to Landmark. Since assuming the operations, Landmark has not submitted any sworn statements, nor paid the required one percent fee.

Recommendation 8: Aviation should work with Law to determine the best course of action to retrieve any fees and penalties owed by Landmark.

MSD has not paid Lunken for 6 years worth of rent.

On April 1, 2003 MSD and T&E entered into a Memorandum of Understanding for use of the ash pits at Lunken Airport. MSD requires lagoons to store the ash produce from the disposal of solid wastes at the treatment plant, located immediately adjacent to the airport. The Federal Aviation Administration requires that Aviation receive fair market value for the airport property, which was determined to be \$70,000 per year, to be paid annually by MSD to Aviation.

IA reviewed data in the Cincinnati Financial System (CFS) to determine if these annual payments have been made, but only found evidence of two payments, one in 2005 and one in 2012, totaling \$140,000. Due to limitations in data, IA could not determine if any payments were made prior to 2005. Payments were missing for a six year period from 2006 to 2011, amounting to \$420,000.

Recommendation 9: MSD should pay back-rent in the amount of \$420,000 to Fund 104 – Lunken Airport in accordance to the Memorandum of Understanding between MSD and T&E.

III. Conclusion

There are a number of issues within this report that speak to a breakdown in communication between the Aviation Division and other City Departments. Leases contain different terms than those laid out in the Municipal Code, contracts are allowed to expire without being renegotiated, departments are not paying the required fees for land use, and others.

While airport operations are typically found within municipal governments, they do not fit within the ordinary business of such, and can result in isolation. Increased efforts should take place to ensure that isolation does not occur and that the needs of the airport are accomplished.

IV. Department of Transportation and Engineering Response

Recommendation 1: Aviation should conduct reviews of the payments made by Brakvill, Inc. to ensure that they are paying the required amount every month.

Response: DOTE concurs. Although the current lease with Brakvill, Inc. was passed by City Council in February, 2007, the lease extended the terms and conditions of the previous lease, a. that Brakvill had assumed when it took over operations of the restaurant in 2006. Current Aviation administration did not compare the lease against the Municipal Code with the assumption it and the previous lease complied with existing statutes.

Aviation staff will reconcile revenue reports from Brakvill, Inc. beginning immediately.

DOTe respectfully suggests that the current base rental rate be removed from the Municipal Code to permit the Airport Manager some flexibility to respond to current market conditions and demand.

Recommendation 2: Aviation should work with the Law Department to ensure that leases and the Municipal Code are in agreement.

Response: DOTE agrees. Department staff will meet with Law Department staff to develop a process which ensures all leases and airport payments are consistent with Municipal Code.

Recommendation 3: Aviation should ensure that landing fees are paid at the correct amount and work to ensure that any systems utilized for payments reflect required amounts.

Response: DOTE agrees. With the new Bruel-Kjaer tracking services, Aviation is better positioned to comply with this recommendation. Aviation staff will work with Law to develop processes to ensure airport payments are consistent with the Municipal Code.

Recommendation 4: Landing fees should be collected for any time that they are due.

Response: DOTE concurs, as this is current practice. Aviation currently collects landing fees when they are due.

Recommendation 5: Aviation should renegotiate contracts before they expire if a tenant wishes to renew, or find a new tenant as quickly as possible.

Response: DOTE concurs. There have been delays in getting new leases in place as negotiations develop, rent rates settled, surveys/assessments and evaluations conducted, etc. An Aviation staff position was recently upgraded to permit assignment of additional responsibilities to the position, specifically lease review and management. That employee will catalog and routinely review Aviation leases and notify Aviation Management staff in advance of lease "due" date to accommodate negotiations and provide sufficient time to complete new agreements. The employee will also monitor these leases for tenant compliance with their respective terms and conditions.

While we concur with this recommendation, we do take exception with the presumption that reversion to a month-to-month lease arrangement results in a loss of revenue. Month-to-month leases do have that potential, but given market conditions at a point in time may not warrant increases in a lease rate.

Recommendation 6: A property management position should be created to aid in the maintenance and development of leases for the airport. This is a specialized position and should have appropriate knowledge of airport operations and needs.

Response: DOTE concurs.

Recommendation 7: Aviation should research and determine if the 1% of gross revenue is appropriate and has kept pace with current airport practices.

Response: DOTE agrees. The practice of a flat 1% of gross for all revenue generating activities at the airport is not consistent with typical airport practices. Most airports require different activities occurring on airport property to pay varying amounts depending on the service provided. For example a restaurant or a rental car facility may pay a higher percentage than a flight school. Aviation will undertake a benchmarking exercise to determine current rates and practices at other similarly sized positioned airports in our region.

Recommendation 8: Aviation should work with Law to determine the best course of action to retrieve any fees and penalties owed by Landmark.

Response: DOTE concurs. This process has already begun.

Recommendation 9: MSD should pay back-rent in the amount of \$420,000 to Fund 104 – Lunken Airport in accordance to the Memorandum of Understanding between MSD and T&E.

Response: DOTE concurs. This process is underway. DOTE is generating a memo to the Director of the Metropolitan Sewer District (MSD) requesting payment of back-rent.