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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

May 20, 2004

Mr. Joseph H. Boardman
Commissioner
Department of Transportation
State Office Building Campus – Building #5
Albany, NY 12232

Re: Privatization of Stewart International Airport
Monitoring of Lease Agreement
Report 2002-S-57

Dear Mr. Boardman:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution, and Article II, Section 8 of the State Finance Law, we have audited the actions taken by the Department of Transportation in monitoring compliance with certain provisions in its 99-year lease for the operation and improvement of Stewart International Airport for the period April 1, 2000 through May 1, 2003. This is the first of two reports that we have prepared addressing the Department's privatization of Stewart Airport. The other report (2003-S-38) addresses capital projects at Stewart Airport.

A. Background

Stewart International Airport (Stewart) is located in New Windsor, New York, near the City of Newburgh, about 60 miles north of New York City. A former Air Force Base, Stewart was acquired by the Department of Transportation (Department) in 1982, and was operated by the Department with the assistance of contractors until April 1, 2000. At that time, as part of an airport privatization program sponsored by the Federal Aviation Administration (FAA), the Department leased Stewart to SWF Airport Acquisition, Inc. (SWFAA), a subsidiary of the National Express Corporation, for a period of 99 years.

Stewart Field first opened in the late 1930s as a small Army aviation field associated with the U.S. Military Academy at West Point. During World War II, the facility was converted to a major military base and in 1948 became Stewart Air Force Base, housing the Strategic Air Command. In 1969, 1,552 acres were purchased by the Metropolitan Transportation Authority (MTA) for use as a fourth major airport for the New York City metropolitan area. In 1971, an

additional 8,000 acres of land adjacent to the airport, known as the Stewart Airport Properties, were purchased by the MTA for the purpose of accommodating expanded airport operations and airport compatible development. However, the development of larger commercial aircraft reduced the need for a reliever airport serving New York City, and in 1982, operational jurisdiction for the airport was shifted from the MTA to the Department.

Beginning in 1985, the Department commissioned a development plan and later initiated a master plan for the airport and its surrounding properties. The Department also sought to upgrade the facilities through various capital projects. In 1997, in an effort to enhance the performance and efficiency of Stewart for airlines and other airport users, enhance the surrounding business environment, develop the facility in an environmentally responsible manner, return assets to the tax base, and provide an appropriate financial return to New York State, the Department and the Empire State Development Corporation jointly issued a Request for Proposal seeking a private company to take over airport operations. This privatization effort was intended to, and did, qualify for certain regulatory exemptions available under Section 149 of the Federal Aviation Authorization Act of 1996, which establishes an airport privatization pilot program and authorizes the Federal Department of Transportation to grant exemptions from certain statutory and regulatory requirements for up to five airport privatization projects.

SWFAA's parent company was selected as the preferred bidder in response to the Request for Proposal, and on April 1, 2000, assumed control of Stewart under the terms of a 99-year lease with the Department. The lease required that SWFAA pay the Department a total of \$35 million: \$24 million upon the signing of the lease; \$6 million when four parcels of property formerly used for landfill have been fully remediated by the Department and transferred to SWFAA; and \$5 million when a contract is awarded by the State for the construction of a new access road to Stewart. The construction of this planned access road has been delayed by ongoing litigation initiated by civic and environmental groups opposed to the development of the land affected by the construction of the planned access road. This pending capital project is discussed in detail in Report 2003-S-38.

The lease also calls for SWFAA (1) to pay the Department a share of Stewart's operating income if the number of enplanements (the arrival or departure of airplane passengers) at Stewart exceeds 1.38 million a year, and (2) to invest \$48.6 million in capital improvements at Stewart during the first five years of the lease period, subject to certain contingencies. In addition, SWFAA is to comply with certain administrative requirements, and the Department is to complete certain capital projects that were initiated prior to the lease. The lease may be assigned to another party by SWFAA anytime after the fifth year, subject to the Department's written approval.

As is shown by the following table, the number of passenger enplanements at Stewart has decreased each year since 2000:

Calendar Year	Enplanements	Percent Decrease
2000	264,351	--
2001	200,828	24%
2002	179,468	11%

However, it should be noted that, during approximately the same period (the three Federal fiscal years ended September 30, 2002), the total number of passenger enplanements in the United States decreased by 15 percent from 669.3 million to 570.3 million, as a result of the downturn in the national economy and the loss of business in the aviation industry after the events of September 11, 2001.

In accordance with the Federal Aviation Authorization Act, the FAA is required to report on the privatization of Stewart. The initial report should have been published by April 2002 (two years after the lease was signed), but FAA officials told us that this initial report was still in draft form and would not be released until early 2004. (As of the date of this audit report, it has not been issued.)

SWFAA activities at Stewart are monitored by a number of Department staff on a part-time basis. Overall operations are monitored by the Director of Passenger Transportation and one staff member from the Passenger Transportation Division. Legal issues are monitored by a staff from the Counsel's Office, and environmental issues are monitored by a staff in the Environmental Analysis Bureau. In addition, capital projects are monitored for compliance with building codes on a full-time basis by a staff person who is stationed at Stewart. The Department's Director of Passenger Transportation also serves as Executive Secretary of the Stewart Airport Commission, a citizen advisory body that meets bimonthly and monitors Stewart's development and operations.

B. Audit Scope, Objectives and Methodology

We audited the actions taken by the Department in monitoring SWFAA compliance with selected terms of the lease for the period April 1, 2000 through May 1, 2003. The primary objective of our performance audit was to determine whether the Department has mechanisms to adequately monitor SWFAA's compliance with lease requirements relating to capital improvements and selected administrative matters. We also determined whether the Department has mechanisms to adequately monitor its own compliance with requirements relating to capital projects.

To accomplish our objectives, we interviewed Department managers and staff, SWFAA officials, and officials from the Department of Environmental Conservation. We also reviewed and analyzed Department and SWFAA records, and visited Stewart to observe the status of capital projects.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and do our audit to adequately assess those procedures and operations included within the audit scope. Further, these standards require that we understand the Department's internal control systems and compliance with those laws, rules

and regulations that are relevant to the Department's procedures and operations that are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures, as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach when selecting activities to be audited. This approach focuses our efforts on those procedures and operations identified through our preliminary survey as having the greatest probability for needing improvement. Consequently, by design, we use our finite audit resources to identify where and how improvements can be made. Thus, we devote little audit effort to reviewing procedures and operations that may be relatively efficient or effective. As a result, our audit reports are prepared on an "exception basis." This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State, several of which are performed by the Division of State Services. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under Generally Accepted Government Auditing Standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

C. Results of Audit

We found that certain improvements are needed to strengthen the Department's monitoring of SWFAA's compliance with the lease. For example, if certain conditions are met, SWFAA is to invest \$48.6 million in capital improvements at Stewart by April 2005. However, a reporting mechanism has not been established that would enable the Department to monitor either the level of SWFAA's capital expenditures or the status of the various conditions. We recommend that such a mechanism be established. We also recommend that the Department establish a reporting mechanism such that the Department of Environmental Conservation can inform it of any environmental violations detected at Stewart. We determined that, contrary to the terms of the lease, a wastewater discharge violation involving a deicing fluid (glycol) was not reported to the Department by SWFAA.

We also found that the Department has yet to be paid by SWFAA for parcels of land that were remediated by the Department in accordance with the lease. Two such parcels were to be transferred to SWFAA by April 1, 2003, and the Department was to receive \$1.5 million for the two parcels. The Department attempted to transfer the parcels in March 2003, but SWFAA indicated the parcels were not remediated to its satisfaction and therefore did not accept them. As of August 2003, SWFAA had yet to accept the land, and as a result, the Department had yet to collect the \$1.5 million. We recommend the Department promptly resolve the disagreement about the adequacy of the remediation, and collect the \$1.5 million.

1. Administrative Activities

According to the terms of the lease, each year SWFAA is to arrange for an independent audit of Stewart's financial operations, and is to submit the resulting audit report to the Department. However, we found the Department has yet to obtain an audit report about Stewart's operations under SWFAA. As a result, the Department has less assurance than it could have about the accuracy and completeness of the financial information provided by SWFAA. Department officials told us they did not request the audit report, because they misinterpreted the lease language. They stated that they now agree an annual audit is required, and they will request the audit beginning with calendar year 2002. SWFAA officials told us that they have arranged for a CPA firm to perform the audits for 2002 and 2003, and they will submit the reports for both years to the Department at the same time.

The lease also requires that SWFAA provide the Department with quarterly reports containing gross income resulting from Stewart's operations. We found that the Department has received all the required quarterly reports. However, when we asked Department officials for documentation showing how they had analyzed the reports, we were told that Department staff informally scan the reports for questionable information or obvious discrepancies, but do not formally analyze or verify the data in the reports. They indicated that they do not perform in-depth analysis, and do not document their informal analysis, because enplanement levels are not yet high enough to result in income for the Department.

In the absence of any documentation describing the nature of the Department's review of the quarterly reports, there is less assurance that this review was thorough enough to protect the State's interests in Stewart. Formal, in-depth analysis should be performed to provide insight into trends and to assess the accuracy of the information in the reports, which are not audited. Department officials believe formal analysis is not warranted, and note that significant inaccuracies would be detected by the independent annual audit. We note that the Department's own informed analysis of the information in the quarterly reports would complement the independent audits by providing additional insights into the numbers certified by the auditors.

(Responding to our draft audit report, Department officials disagreed with our assessment of their review of the quarterly reports. They believe that the informal analysis done by an experienced employee is sufficient. They are confident that they will pick up on any amounts that are not in keeping with historical revenue trends. We accept that the income reports are reviewed, but the Department needs a formal record as to what the reviewer did and the written results of the review as evidence of the process. Without a permanent record of the reviews there will be less information available for future management and staff assigned to this task.)

According to Section 400, Subdivision 3(i) of the State Transportation Law, the State is to submit payments in lieu of taxes (PILOTs) to the municipalities in which Stewart is located for any land used for non-aviation purposes at Stewart. PILOTs are not required for land used for aviation purposes. Since some of Stewart's property is used for non-aviation purposes, the municipalities in which this property is located (the Town of New Windsor and the City of Newburgh) should receive PILOTs from SWFAA.

SWFAA officials told us that they either pay PILOTs to the two municipalities or confirm that tenants pay the tax bills sent by the municipalities. However, the Department does

not verify that SWFAA does, in fact, comply with the requirement. Rather, Department officials rely on the municipalities to complain if PILOTs are not paid. We spoke with officials from the two municipalities, and they told us that no PILOTs were outstanding at the time of our audit field work. To provide assurance that PILOTs are kept up to date, we recommend that the Department periodically obtain PILOT payment documentation from SWFAA.

A Department staff member is assigned full-time to Stewart to monitor the building code compliance of the construction projects at Stewart that may be undertaken by SWFAA or various airport tenants. The Department and SWFAA must approve all tenant improvement projects. We examined the process used by the Department in monitoring these projects and found that it is generally sound. The Department staff person obtains a list of all construction projects starting or in process, and inspects the projects to enforce all relevant building codes. The staff person told us that he regularly tours Stewart to determine whether any unreported projects are in process. However, the only written record maintained by the staff person relates to annual fire/safety inspections. All other monitoring activities such as the regular tours to identify unreported projects are not documented. Therefore, the Department could not demonstrate the level of monitoring actually performed. We recommend that all the Department's inspection, observation and related monitoring activities be documented.

(In response to the draft report, Department officials indicated that instances of non-compliance are documented and they disagreed there is a need to document the activities of the code compliance officer. However, we continue to maintain that the inspections activities should be documented to ensure that the information is available for management and staff that are not familiar with the process or are assigned to Stewart in the future.)

Department officials generally believe that the actions we recommend are management responsibilities rather than monitoring responsibilities, and thus need not be done by the Department, as the Department does not operate Stewart. We disagree, and note that the Department must actively and systematically monitor operations at Stewart if the State's interests in the land and the facilities are to be adequately protected. These interests will not be properly protected if the Department's oversight is casual and distant. Conditions at Stewart are likely to change significantly over the long life of the 99-year lease, and if the Department does not keep itself informed about these conditions, or document its observations and related activities, unexpected and unplanned for developments could undermine the State's interests.

2. SWFAA Capital Activities

According to the lease, SWFAA is to invest \$48.6 million in Stewart, subject to certain contingencies, during the first five years of the lease (the five year period that ends March 31, 2005). This investment is to take the form of various capital projects, which are generally described in a preliminary capital improvement plan that is included in the lease. The \$48.6 million is to include no more than \$10.3 million from SWFAA; at least \$38.3 million is to come from Federal grants and passenger fees at Stewart (according to Federal regulations, a certain fee must be paid by each passenger on a commercial flight). SWFAA is required to invest the full \$48.6 million only if sufficient revenue is obtained from the grants and fees, and only if certain business-related goals are met at Stewart (e.g., passenger and cargo volumes must attain certain levels, certain costs must not exceed certain levels, and commitments must be obtained from third parties to develop certain facilities). In addition, each year, SWFAA is to submit to the

FAA an updated five-year capital improvement plan, and provide the Department with a copy of the approved plan.

The capital improvements to be made by SWFAA include the rehabilitation and improvement of aircraft runways and taxiways, the expansion of cargo facilities, the improvement and expansion of terminal buildings, the rehabilitation and improvement of airfield lighting, and the rehabilitation and improvement of sewers and glycol collection systems (glycol, which is used to deice airplanes, can pollute groundwater if it is not properly collected and disposed). If these improvements are not made, Stewart may not be a commercial success in the future, and the State will not receive a share of Stewart's operating income. Thus, it is important for the Department to closely monitor SWFAA's level of capital investment at Stewart. Moreover, since the level of investment expected of SWFAA is contingent on several factors (Federal grants, the development of facilities, etc.), it is equally important that these factors also be closely monitored by the Department.

However, we found that a mechanism has not been established for reporting this information to the Department. SWFAA does not periodically report its total capital expenditures to date, and does not periodically report the status of the factors affecting the total amount of capital expenditures that are to be made in the first five years of the lease (such as the total amount of Federal grants received to date, the total amount of passenger fees, and the progress made in achieving the business-related goals specified in the lease). As a result, the Department's monitoring of a critical lease requirement is made more difficult. We recommend that this information be periodically reported to the Department by SWFAA.

If certain conditions are met, SWFAA will be expected to make \$48.6 million in capital expenditures by March 31, 2005. To determine whether SWFAA's capital expenditures are likely to reach this level by that date, we examined the capital expenditures made and planned by SWFAA. We found that, as of March 31, 2003, three full years into the lease, SWFAA had reportedly spent about \$23.8 million on capital improvements, or nearly half the amount called for. To verify the accuracy of SWFAA's reported capital expenditures, we judgmentally selected 56 of 336 entries, totaling \$8.1 of the \$23.8 million reported on March 31, 2003, and traced the selected expenditures to supporting documentation. Our sample selection was based on dollar value that included all transactions exceeding \$750,000 and included at least one transaction for each project. We found these expenditures were documented.

SWFAA's reported capital expenditures related to eight separate projects, which are listed in the following table:

Ongoing SWFAA Capital Projects				
Description	Cost (Millions)		Time Period for Construction Work	Status As of May 2003
	Actual to 12/31/02	Final Estimated		
North Cargo Expansion	\$8.32	\$9.20	4/11/01 - 9/27/01 8/27/01 - 2/9/02	Completed - not closed out
Relocation of Airfield Lighting Control Vault - Construction Only	.08	2.25	11/1/02 - ongoing	Project Bid
Runway 9/27 Overlay- Construction Only	7.05	7.20	8/24/00 - 7/27/01	Completed - not closed out
Navigational Aids	.60	1.50	10/23/02 - ongoing	Not Completed
Glycol System Rehab	4.86	5.18	9/26/01 - ongoing	Close-out Phase
Taxiway H Widening/Rehab	1.40	2.50	8/20/01 - 10/24/01	Completed 12/7/01
Ramp Rehabilitation	.11	3.73	Delayed	Design Phase
Industrial Park Sewer Improvements	.02	.76	Spring 03	Not Completed
Total	\$22.44	\$32.32		

We further determined that SWFAA plans to begin 13 additional capital improvement projects prior to March 31, 2005, and the estimated final cost of these projects and the eight projects already started is expected to total about \$53 million, as follows:

Project Description	Expected Start and Completion	Estimated Cost (Millions)
Eight Ongoing Projects		\$32.32
Security Upgrade	1/03 - 5/03	.37
NE Quadrant Expansion Multi-Use Apron	4/03 - 6/03	.70
Rifton Hangar Access Taxiway	5/03 - 6/03	.38
Airfield Snow Removal Equipment	10/03 - 11/03	.95
Terminal Building Improvement	2/04 - 8/04	2.00
Security System Upgrade Phase II	3/04 - 6/04	.50
Runway 16 Obstruction Removal	4/04 - 6/04	1.50
Rehab Airfield Taxiway Lighting	11/04 - 10/05	1.60
Rehab Runways 9/27 & 16/34 Lighting	11/04 - 10/05	1.60
Taxiway Rehabilitation - Phase I	1/05 - 9/05	1.50
Bomb Blast Protection - Analysis & Construction	2/05 - 8/05	.75
Aircraft Ramp Rehabilitation - North Terminal Area	N/A - bid 6/03	4.60
Runway Safety Area Improvements R/W 16/34	N/A	4.25
Total		\$53.02

N/A – Start and completion dates have not yet been estimated

Thus, if all 21 projects are completed at their estimated cost, SWFAA's capital expenditures will exceed the \$48.6 million called for by the lease. However, six of these projects, which together are expected to cost \$14.3 million, have an expected completion date after March 31, 2005. Four of the projects (\$5.45 million) are expected to be completed between August and October 2005, and two of the projects (\$8.85 million) have not been given estimated start/completion dates.

We therefore conclude that, while SWFAA's capital expenditures could reach the level conditionally expected for the first five years of the lease, they could also fall short of this level. Our analysis thus shows that these expenditures (and the contingencies related to these expenditures) need to be closely monitored by the Department, particularly since SWFAA is allowed to assign the lease to another party after five years if they receive the Department's written approval. Before approving any such assignment, the Department would need to know whether all capital improvement requirements had been met by SWFAA, and if they had not been met, whether they were to be assumed by the new lessee.

We also examined the status of one of the contingencies related to SWFAA's capital expenditures: the amount of Federal grants and passenger fees received by SWFAA. According to the terms of the lease, at least \$38.3 million of the \$48.6 million in capital expenditures is to be funded by such grants and fees. SWFAA reported that, as of June 30, 2003 (which was 65 percent of the way through the initial five-year lease period), it had received \$21.2 million in Federal grants and passenger fees (which was 55 percent of the \$38.3 million needed). We note that this funding level was not being monitored by the Department.

We also note that Federal grants can be terminated if a project takes too long to complete. In fact, as of January 2000, all new federally funded airport projects had to be completed within four years to retain their funding. It is therefore important for the Department to monitor the timeliness of SWFAA's federally funded projects.

(In response to the draft report, Department officials disagreed with the need for additional monitoring of SWFAA's capital investments at the Airport. They cite the fact that the investment level can change. We agree that the investment level is not fixed, but this does not obviate the need for the Department to monitor the level and the factors that can change it.)

3. Department Capital Activities

According to the lease, the Department is to complete nine capital-related projects that were begun before Stewart was leased to SWFAA. We examined the status of these nine projects, which were expected to cost a total of \$32.4 million. We found that as of May 1, 2003 three of the projects, with actual costs of about \$9.1 million, had not been completed. The status of these three projects (the construction of a fuel storage facility, the construction of an approach to a runway, and the development of a master plan for Stewart) is addressed in detail in Report 2003-S-38.

We further found that three of the six completed projects had yet to be formally closed by the Department. Department officials told us that, while construction was completed on these three projects, the projects were not closed because the Department was in the process of obtaining reimbursement for project expenses that had been funded by the State. Passenger fees

related to the constructed facilities can be used to reimburse the expenses. As of July 2003, the Department was still eligible for another \$4.2 million in passenger fee reimbursement on projects that have not been closed-out. Department officials indicated that, as these fees are generated from the air traffic at Stewart, the Department will apply for the available reimbursement and will promptly close out the projects once all available reimbursement has been obtained.

In addition, according to the terms of the lease, SWFAA is to pay the Department \$6 million when four parcels of property formerly used for landfill have been fully remediated by the Department and transferred to SWFAA. Two of the parcels (Parcels A and B) were to be transferred to SWFAA by April 1, 2003, at which time the Department was to be paid \$1.5 million. The remaining \$4.5 million is to be paid when the remaining two parcels are transferred. According to the lease, Parcel C is to be transferred by April 1, 2005 and Parcel D is to be transferred by April 1, 2007.

On March 24, 2003, the Department attempted to transfer Parcels A and B to SWFAA. However, SWFAA did not accept the parcels, because it contended that they had not been properly remediated. On April 25, 2003, Department officials asked the New York State Department of Environmental Conservation (DEC) to affirm that the parcels had been properly remediated. In a letter dated July 10, 2003, DEC stated that the remediated parcels could be used for their intended purpose, which was to contain newly constructed aircraft hangars. However, in a letter dated August 8, 2003, SWFAA continued to contend that the parcels had not been properly remediated, and continued to refuse to accept the land. As a result of this refusal, the Department had yet to collect the \$1.5 million from SWFAA.

Department officials indicated that the \$1.5 million to be paid for Parcels A and B is covered by a letter of credit which has been invested by SWFAA in an interest bearing account, and the Department will receive all the interest earned. The officials further indicated that these funds are to be deposited in its Regional Aviation Fund, which supports operations at the two State-owned airports (Stewart and Republic Airport on Long Island). According to FAA requirements, the \$1.5 million received from SWFAA will have to be used for airport purposes. Department officials stated that, at the present time, neither Stewart nor Republic has pressing needs that could be addressed by these funds. Department officials therefore conclude that no harm results from the delay in collecting payment from SWFAA. We nonetheless recommend that the Department promptly resolve this disagreement about the remediation of the parcels and promptly transfer the funds belonging to the State. (In response to the draft report, Department officials indicate that they continue to work with SWFAA to resolve the issue and will transfer the funds when it is in the best interest of the Department.)

In addition, to prevent this kind of delay in SWFAA's payment of the \$4.5 million for Parcels C and D, we recommend the Department seek DEC's written approval for these parcels before they are scheduled to be transferred to SWFAA. We also recommend that, before proceeding with the remediation of Parcels C and D, the Department and SWFAA establish how the remediation will be validated to the satisfaction of both parties.

4. Environmental Reporting Requirement

According to records maintained by DEC, on March 3, 2002, DEC officers on patrol observed SWFAA employees discharging deicing fluid (glycol) into a stream in a manner that was contrary to SWFAA's State Pollution Discharge Elimination System permit. According to DEC officials, the deicing fluid should be conveyed into the stream by means of a specially installed drainage system. An SWFAA official told us that the drainage system was not working that day. Therefore, SWFAA employees collected the deicing fluid after it had been used to deice planes, transported the fluid to the place where the drainage system emptied into the stream, and poured the used fluid into the stream.

As a result of this wastewater discharge violation, SWFAA was fined \$2,500 by DEC. According to the terms of the lease, SWFAA should have informed the Department of this violation. However, SWFAA did not inform the Department. SWFAA officials told us they did not inform the Department because they did not realize they were required by the lease to do so. They stated that the Department has now made them aware of the requirement.

Stewart will revert to the State when the lease expires therefore, the Department needs to be aware of all environmental issues affecting the property. State Pollution Discharge Elimination System permit violations and other types of environmental violations could create conditions that need to be remediated. We therefore recommend the Department coordinate with DEC to establish a reporting mechanism that informs the Department of all environmental violations detected at Stewart.

Recommendations

1. Improve the monitoring of SWFAA's compliance with lease and other requirements by:

- *Obtaining the annual audit report in a timely manner.*

(Department officials agree with this recommendation and SWFAA's auditors are currently preparing the reports for 2002 and 2003.)

- *Formalizing and documenting the analysis of SWFAA's quarterly reports.*

(Department officials replied that the quarterly income reports receive an appropriate level of review and do not agree it warrants formalization. However, they have started to document the review for evidentiary purposes.)

Auditor's Comments: In addition to documenting that the review took place, a more formal record describing the nature of and the results of the review should be prepared.

- Periodically verifying payment of PILOTs.

(Department officials agreed to periodically verify PILOT payments with the towns.)

- *Documenting all building code compliance inspections and related activities.*

(Department officials replied that code compliance records are currently sufficient.)

Auditor's Comments: As previously indicated, the Department's practice of just recording instances of non-compliance does not provide an adequate record of activities performed by the code compliance officer. In the absence of such a record it is difficult to determine with any certainty what areas of Stewart were reviewed and when.

- *Establishing a mechanism for reporting SWFAA's capital expenditures and the status of the contingencies related to the expenditures.*

(Department officials responded to our draft report that, they disagree with our recommendation because existing monitoring efforts are sufficient to know SWFAA is making a capital improvement.)

Auditor's Comments: We disagree that the Department's existing monitoring practices are sufficient because they do not include monitoring information such as the amount of Federal grants and passenger fees received by SWFAA or changes in capital projects that are planned by SWFAA.

2. *Promptly resolve the disagreement about the adequacy of the remediation of Parcels A and B, and promptly collect the \$1.5 million due from SWFAA for the two parcels.*

(Department officials replied to the draft report that, they will continue to work with SWFAA to resolve this issue. They added that the letter of credit will be extinguished and the funds transferred to the Department's Regional Aviation Account when determined to be in the best interest of the Department.)

Auditor's Comments: The lease requires the transfer of parcels A and B by April 1, 2003. We were also advised that the parcels were remediated to a level appropriate for the intended use of building a hangar. However, almost 10 months later the parcels have not been accepted by SWFAA and the Department's response does not provide any indication when this matter will be resolved. We believe that Department officials need to change their position and take action to closeout this issue.

3. *Before proceeding with the remediation of Parcels C and D, establish to the satisfaction of both the Department and SWFAA how the remediation will be validated. Validate the remediation of the two parcels before they are scheduled to be transferred to SWFAA.*

(Department officials replied to our draft report that, they will continue to hold regular meetings with SWFAA on environmental issues and will ensure remediation of the parcels in accordance with the Lease.)

Auditor's Comments: The Department's reply does not specifically address our recommendation. Therefore, there is a risk that the same types of disagreement that arose with parcels A and B could occur with parcels C and D.

4. *Coordinate with DEC to establish a reporting mechanism that informs the Department of all environmental violations detected at Stewart.*

(Department officials agreed to request DEC to notify the Department of any environmental violations detected at the Airport.)

Draft copies of in this report were provided to Department of Transportation officials for their review and comment. Department officials agree with some of our recommendations and indicate that they are implementing them. Their comments have been considered in preparing this final report, and are included as Appendix A. Appendix B, State Comptroller's Notes, includes our comments with respect to certain matters contained in the Department's response to our draft audit report.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the Department of Transportation shall report to the Governor, the State Comptroller, and the leaders of the Legislature and its fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Major contributors to this report were Gerald Tysiak, Stephen Goss, Myron Goldmeer, James Pugliese, Jennifer Paperman and Dana Newhouse.

We wish to thank the management and staff of the Department of Transportation for the courtesies and cooperation extended to our auditors during this audit.

Very truly yours,

Carmen Maldonado
Audit Director

cc: Robert Barnes, DOB
John Samaniuk



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Re: Privatization of Stewart International Airport
Monitoring of Lease Agreement
Report 2002-S-57

Dear Ms. Maldonado:

Thank you for the opportunity to respond to your “Working Draft” report regarding the Department’s monitoring of its Lease Agreement (Lease) with Stewart Airport Acquisition, Inc. (SWFAA).

The Department’s Lease with SWFAA is a “Privatization Lease” authorized under a Federal Aviation Administration (FAA) pilot program. Privatization under this agreement means that the lessee, SWFAA, has stepped into the shoes of the Department of Transportation (Department) as the “Sponsor” of Stewart Airport for the purposes of receiving FAA funds, operating, maintaining and developing the Airport. It is the intention and structure of the Lease that SWFAA be able to do so with a minimum of State monitoring or interference. Towards that end, the Department remains informed of conditions at the Airport via Lease-required communiqués/reports, Stewart Airport Commission meetings, environmental meetings, and day-to-day interaction between SWFAA and the Department on joint Airport issues. The Department disagrees with the interpretations of the audit that additional monitoring is needed to safe-guard the State’s interest in the Airport.

The Department finds that there are several inaccuracies in the audit report. The first and most critical is the statement that SWFAA is committed to invest \$48.6 million in capital improvements at Stewart by April of 2005. The dollar amounts contained within the Lease are reflective of SWFAA’s initial five year Capital Improvement Plan for the period ending April 2005. However, Article 13 of the Lease provides that these investment amounts and the Plan are subject to change at the discretion of SWFAA and the FAA, and do not require State approval. The Lease was structured in this manner to allow SWFAA the flexibility to adjust its capital investment level based on the business climate. In accordance with the Lease, SWFAA has annually filed a new plan with the FAA, and related investment levels have changed. At no time was it the intention of the Department or the Lease to have SWFAA maintain a specified level of

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Note
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capital investment. Accordingly, the Department disagrees with any statements, findings or recommendations within the audit which call for additional monitoring of SWFAA's capital investment at the Airport.

The audit repeatedly refers to SWFAA's "payments" for remediated parcels. These statements are misleading in that they depict the funds as "to be paid" to the Department. The funds for these parcels are already in the possession of the Department in the form of a Secured Letter of Credit. This letter of credit earns an interest rate of 6.19% annually. SWFAA is not required to make additional "payments", but rather the Department has to transfer the funds from the letter of credit to the Regional Aviation Account. The Department can move the funds without prior approval from SWFAA; however, in the interest of continuing our positive "private/public partnership", the Department has chosen not to do so until our differences regarding Parcels A & B are resolved. The availability of the funds is not in jeopardy and they continue to earn an above market rate of return while the Department continues to work with SWFAA on the resolution of issues regarding Parcels A & B.

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The Department disagrees with the audit's assessment of the Department's review of the quarterly gross income reports from SWFAA. These reports are reviewed by a staff member who has many years of experience in the area of revenues at Stewart Airport. Any amounts which are not in keeping with historical revenue trends and known current activities at the Airport are discussed with SWFAA's accounting staff at the Airport. With passenger levels well below the threshold for additional rent payments, the institution of a formal, in-depth analysis and additional documentation requirements would not be prudent use of limited and valuable staff time.

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With regard to the Department's code compliance efforts, the audit recommends that all the Department's inspection, observation, and related monitoring activities be documented. The code compliance officer at the Airport maintains records regarding all building permits issued, inspections conducted in connection with those building permits, and ultimately records and issues all certificates of occupancy. Regularly, the Code Compliance Officer tours the Airport to determine if there are any unreported construction projects underway. In the event that an unreported project is discovered, the Compliance Officer discusses the regulatory requirements with the tenant and instructs the tenant to obtain the necessary paperwork. To date, the Officer has never had a problem with the tenant complying with this verbal request, resulting in the project being recorded within the building permit files. If he does experience a tenant who does not comply with his initial request, he will document this non-compliance. The Department sees no need to impose further documentation requirements in the area of code compliance.

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Note
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Recommendations:

1. *Improve the monitoring of SWFAA's compliance with lease and other requirements by:
Obtaining the annual audit report in a timely manner.*

The Department agrees with this recommendation and SWFAA's auditors are currently preparing the reports for 2002 and 2003.

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Formalizing and documenting the analysis of SWFAA's quarterly reports.

The Department believes that quarterly reports receive an appropriate level of review and therefore does not agree that this monitoring warrants formalization. However, the Department has begun documenting its review efforts for evidentiary purposes.

Periodically verifying payments of PILOT's.

The Department agrees to verify PILOT payments with the towns.

Document all building and code compliance inspections and related activities.

As described above, the Department believes that the code compliance records are currently sufficient.

Establishing a mechanism for reporting SWFAA's capital expenditures and the status of the contingencies related to the expenditures.

The Department disagrees with this recommendation because, as noted earlier in this response, we believe that existing monitoring efforts are sufficient to know if SWFAA is making capital improvements at a level appropriate for the Airport.

2. *Promptly resolve the disagreement about the adequacy of the remediation of Parcel A and B, and promptly collect the \$1.5 million due from SWFAA for the two parcels.*

The Department will continue to work with SWFAA to resolve this issue. The letter of credit will be extinguished and the funds transferred to the Department's Regional Aviation Account when determined to be in the best interest of the Department.

3. *Before proceeding with the remediation of Parcels C and D, establish to the satisfaction of both the Department and SWFAA how the remediation will be validated. Validate the remediation of the two parcels before they are scheduled to be transferred to SWFAA.*

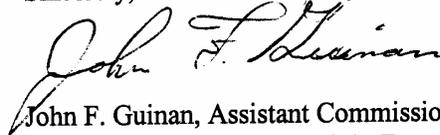
The Department will continue to hold regular meetings with SWFAA on environmental issues and will ensure remediation of the parcels in accordance with the Lease.

4. *Coordinate with DEC to establish a reporting mechanism that informs the Department of all environmental violations detected at Stewart.*

The Department agrees to request DEC to notify the Department of any environmental violations detected at the Airport.

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Sincerely,

A handwritten signature in black ink, appearing to read "John F. Guinan". The signature is fluid and cursive, with the first name "John" being the most prominent.

John F. Guinan, Assistant Commissioner
Office of Passenger and Freight Transportation

cc: D. Taylor, Division of the Budget

State Comptroller's Notes

1. Our report states that SWFAA's investment of \$48.6 million is subject to certain contingencies. Notwithstanding the above, the Department should monitor the investment levels that SWFAA commits to at Stewart International Airport (Stewart) because it is still an asset of the State and systematic monitoring of operations at Stewart helps to protect the State's interest in the land and the facilities. Additionally, conditions at Stewart will change over the life of the 99-year lease, and the Department should monitor such changes to protect the State's interest. In addition, the lease may be assigned to another party by SWFAA anytime after the fifth year, subject to the Department's written approval. It would be a sound business practice for the Department to have a complete, accurate and well documented record of the Airport's physical plant should SWFAA exercise that option.
2. The report reflects the terms of the lease that SWFAA is to pay the State \$6 million when the four parcels of property formerly used for landfill have been fully remediated by the Department and transferred to SWFAA. We understand that the payment is in the form of letters of credit but, nonetheless the Department has not cashed the letters of credit due to the disagreement with SWFAA over the condition of parcels A and B. The report recommends the Department resolve the disagreement over the parcels and promptly collect the \$1.5 million.
3. As cited in the Department's response they already review the quarterly gross income reports from SWFAA. We recommended this process be documented to create a historical record of what the review consists of and any results such as trends identified or problems noted.
4. The Department disagrees with our recommendation to document code compliance inspections and cites the fact that the Code Compliance Officer has never experienced a problem. However, we continue to believe that a permanent record of such inspections be kept. Such a record is necessary to document the level and timing of monitoring actually performed. The fact that problems have not been found so far does not negate the need to document the events that transpire at the Airport. While staffing is always subject to change, a written report serves as a permanent record of the events at Stewart.