COLORADO
Department of Transportation
Division of Aeronautics

5126 Front Range Parkway
Watkins, CO 80137

MEMORANDUM

TO: Colorado Aeronautical Board
FROM: David Ulane, Director
DATE: January 25, 2016
SUBJECT: Division Financial Look Forward

Background

In April 2015, the Colorado Department of Transportation's (CDOT) Division of Aeronautics was issued an $11 million, five year loan by the Office of the State Controller to mitigate potential aviation system impacts arising from the Division's earlier over-obligation of discretionary grant funds and concurrent underestimation of declining Division revenues. This loan provides the Division the ability to honor all outstanding discretionary airport grant obligations, and the opportunity to issue a reduced amount of annual grant funds going forward. Condition #5 of that loan agreement requires that CDOT "put controls in place to assure that CDOT and the Division of Aeronautics are adequately tracking and monitoring revenues and there is proper review of the program by different parties so we can avoid this situation in the future."

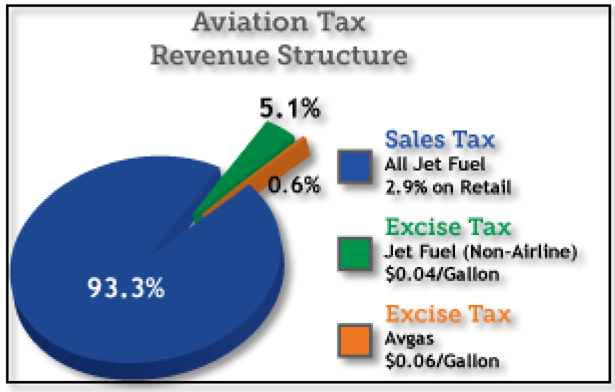
In May 2015, the Colorado Aeronautical Board (CAB), Division of Aeronautics, and CDOT entered into a Memorandum of Understanding (MOU) to "more clearly define collaboration and coordination between CDOT and its Division of Aeronautics in order to achieve the goals of the Division, CDOT and the Colorado Aeronautical Board." The intent of the MOU, in part, was to comply with condition #5 of the State Controller's loan, and to improve the processes, procedures and methodologies by which the Division forecasts and communicates its financial position.

Since that time, the Division has been collaborating closely with CDOT and its Division of Accounting and Finance (DAF) to implement significantly improved revenue forecasting processes and tools, along with a strategy for better communicating those forecasts and expectations with our stakeholders earlier and more frequently. The information presented in this memo is a culmination of those efforts, which we will continue to implement, refine and improve.

Division Revenue Summary

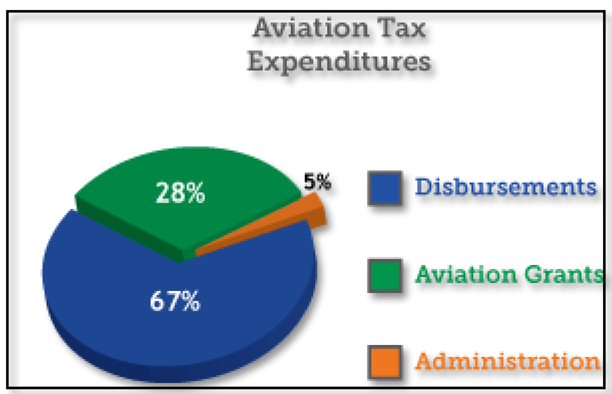
The Division of Aeronautics is funded by three distinct state aviation fuel taxes:

- 2.9% sales tax on all jet fuel
- $0.04 per gallon excise tax on non-commercial jet fuel
- $0.06 per gallon excise tax on aviation gasoline (avgas)



As the chart at the right depicts, over 93% of the Division's revenue is derived from the 2.9% sales tax on jet fuel, with about 85% of that portion generated by Denver International Airport. As Chart 1 in the attached packet shows, the price of jet fuel (and the price of oil from which jet fuel is refined) is highly volatile, and as of January 11th, is at record low of about $0.92 per gallon, the lowest since early 2004. Meanwhile, the price of oil is also lower than it's been since late 2003, hovering around $30 per barrel.

Division Expenditure Summary



Per Colorado Revised Statute 43-10-110, 65% of all revenue from the 2.9% sales tax on jet fuel, and four cents of the six cents per gallon excise tax on avgas are disbursed back to the airport where the fuel was sold. The remaining revenues are used by the Division for its administrative expenses, as well as aviation grants, which include statewide initiatives such as mountain AWOS, airport intern program, surplus equipment program and the Colorado Discretionary Airport Grant (CDAG) program, as shown in the chart to the right.

Revenue Forecasting Philosophies and Challenges

Issuance of airport improvement grants under the Colorado Discretionary Airport Grant (CDAG) program is one of the Division's most important duties. Prior to 2015, the Division obligated its CDAG funds on an obligation basis - that is if the Division received

XX dollars of revenue available for CDAG grants in one fiscal year, it would issue and obligate XX dollars of airport grants the following year. While this philosophy prevented the Division from over-obligating grant funds year over year, over time it created a significant and growing balance in the aviation fund, since many airport projects are completed over several years, with grant drawdowns also taking place over several years. This large balance, which was exacerbated by higher jet fuel prices and division revenues from 2009 through 2014, represented a significant amount of money that was not being put to timely use to improve Colorado's aviation system.

As a result, CDOT (along with the Division and many other transportation agencies nationally) are transitioning to obligating funds on a cash basis, where the multi-year aspects of revenues, cash flows and grant drawdowns are considered, and more funds are put to immediate use. While this greatly enhances the timely and effective use of Division revenues, it also creates the need for enhanced forecasting tools, acumen and attention. This is especially true in the Division's case, where the vast majority of our revenues are based on the volume of fuel sold, but also on its volatile and unpredictable price.

FY 2017 Division Forecasting

The Division of Aeronautics and DAF have refined and implemented a significantly improved model and method for financial forecasting that will not only allow us to more effectively deploy our funds, but also help us to mitigate the kinds of risks that led to the Division's financial challenges in late 2015. This model, however still relies on forecasting the volume and price of jet fuel sold in the state, which is a difficult task, even for energy-industry experts.

As such, the Division's revenue forecasting philosophy will, at least for the near term given low fuel/oil commodity prices, generally portend a pessimistic view, where jet fuel prices remain low, and discretionary airport grant fund amounts and aggregate levels are adjusted as needed to allow the Division to remain in a positive cash position while maximizing investment in our aviation system.

As these forecasts are developed, the Division will communicate these forecasts as early as possible to allow airports to adjust their local budgets and capital improvement programs as necessary. At the present time, the Division's revenue forecasts and associated discretionary grant levels are constrained by three primary factors:

- Current record low oil and jet fuel prices;
- The $11 million limit of the State Controller's loan to the Division; and
- The April 1, 2020 expiration date of the State Controller's loan

It is not feasible to amend either the amount or length of the State Controller's loan, so the Division has developed three forecast scenarios (attached), to demonstrate various financial outcomes based on varying CDAG grant funding levels, and how these outcomes align with the loan terms. All three scenarios have the same revenue forecasts, and are based on the following assumptions:

<u>Revenue Assumptions</u>

- Average oil price of $35 per barrel, with 4% annual escalation from FY17 to FY20
- 32 million gallons per month of jet fuel consumption and historical averages on avgas consumption, both volumes remaining flat from FY17-FY20

<u>Expenditure Assumptions</u>

- Baseline statewide initiatives totaling $1,224,000 annually FY17-FY20 (includes mountain AWOS, airport internship program, DEN surplus equipment, blended airspace/virtual air traffic control tower, USDA Wildlife program, crackfill, 5010 inspections and pavement condition indexing.)
- Annual administrative budget at the maximum 5% of the previous year's revenue, as limited by C.R.S. 43-10-109.

Scenario A:

Scenario A includes the above revenue and expenditure assumptions and the actual CDAG grant awards for FY16. It also reflects the maximum $3,500,000 million of annual CDAG grant awards informally established for the term of the MOU (capped at $250,000 per grant) from FY17 to FY20.

As the graph and data table show, this scenario does not meet the April 1, 2020 State Controller loan deadline, with a projected negative aviation fund balance of ($3,607,771) on that date.

Clearly it is not possible, given current revenue assumptions, for the Division to support a $3,500,000 annual ($250,000 per grant cap) CDAG program from FY17-FY20.

Scenario B

Scenario B includes the above revenue and expenditure assumptions and the actual CDAG grant awards for FY16. It also reflects the currently programmed annual CIP CDAG grant amounts (capped at $250,000 per grant) from FY17 to FY20, which are annually less than the $3,500,000 amount included in Scenario A.

As the graph and data table show, this scenario also does not meet the April 1, 2020 State Controller loan deadline, with a projected negative aviation fund balance of ($1,715,828) on that date.

Under this scenario, it is not probable, given current revenue assumptions, that the Division will be able to support the currently programmed CIP CDAG grant amounts at the $250,000 cap per grant from FY17 to FY20.

Scenario C

Scenario C includes the above revenue and expenditure assumptions and the actual CDAG grant awards for FY16. It also reflects the currently programmed annual CIP CDAG amounts, but capped at **$150,000** per grant, from FY17 to FY20.

As the graph and data table show, this scenario does closely meet the April 1, 2020 State Controller loan deadline, with a projected positive aviation fund balance of $390,437 on that date.

Summary and FY17 to FY20 CDAG Grant Program Expectations

As noted above, the goal of the CAB and the Division is to be proactive and diligent about closely monitoring the Division's current and forecast financial position, and communicating that information to airports and other stakeholders as early as possible.

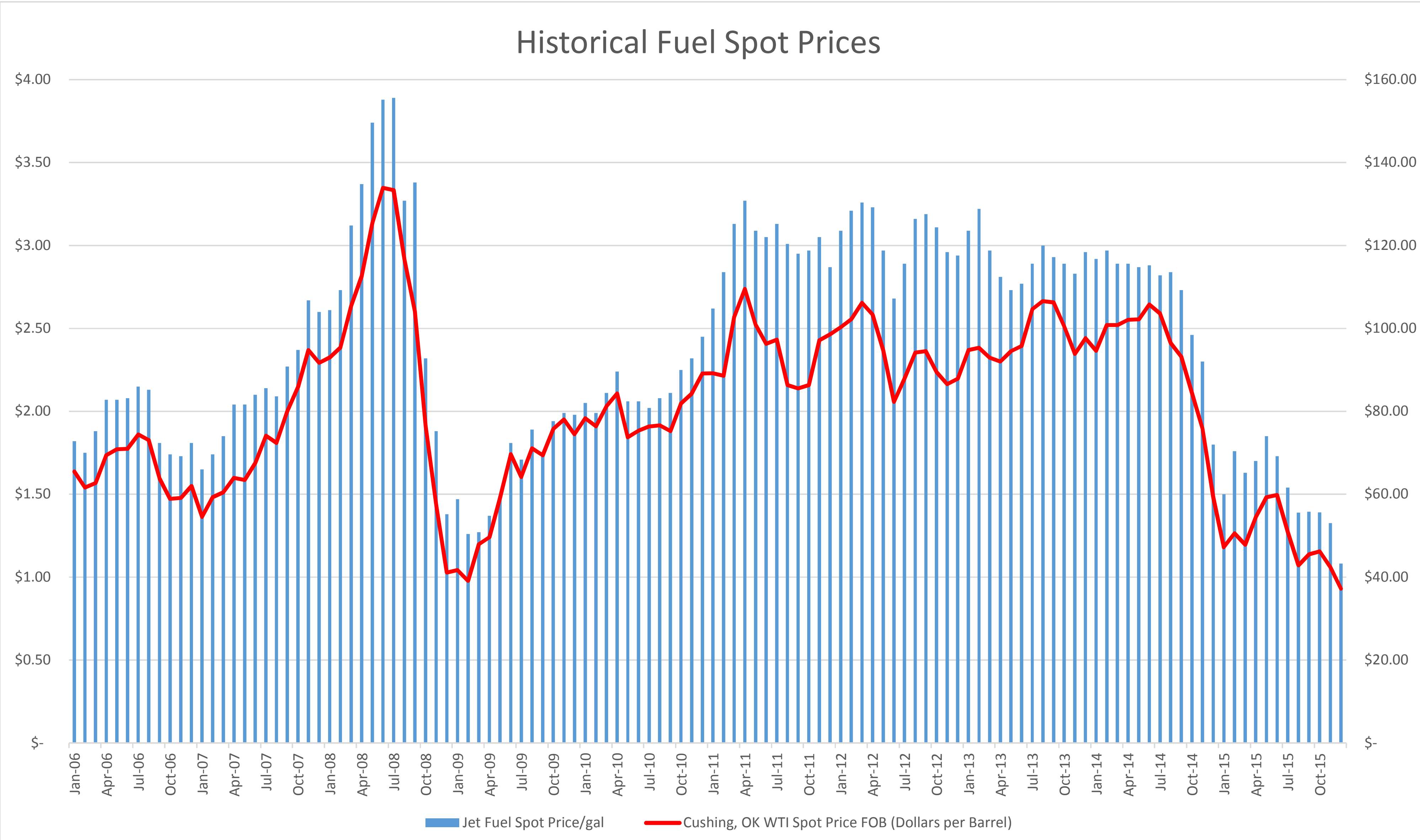
As the attached scenarios demonstrate, it is not feasible under current revenue projections that the Division will be able to issue CDAG grants on FAA-funded projects with a cap of $250,000 in FY17 and beyond. Based on our current information (subject to future revisions), it would be prudent for airports to be planning for the CDAG grant program to continue to match only FAA funded projects in FY17, with a cap on CDAG grants of $150,000, continuing through FY20.

It is important to note that the FY17-FY20 CDAG grant program amounts and caps are not being recommended to the CAB for formal action or establishment at this time - this information is simply the Division's informed view of what impact the current and forecast environment have, barring any unforeseen changes in the energy market.

In May 2016, prior to the CAOA conference in Durango, staff will revisit these scenarios and share any revisions with the CAB and airports at that time. We will also revisit these again in early October, prior to this year's Airport and Consultant Workshop scheduled that month.

While this is certainly a frustrating situation, we feel it's important to convey this message now, as early as possible, to our airport partners and others so that they can begin thinking about their budgets for next year. We know the news is unfortunate, but we *are* following through with our commitment to the aviation community to be more diligent, transparent and communicative about the Division's situation and forecast path forward.

In closing, we believe that being conservative on our revenue forecasts is a much more prudent approach - the Division would rather be in a future position of potentially awarding more grant funds because revenues exceeded our forecasts, rather than reducing funds at the eleventh hour because we were overly optimistic.


Historical Fuel Spot Prices
$4.00
$3.50
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$2.50
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$140.00
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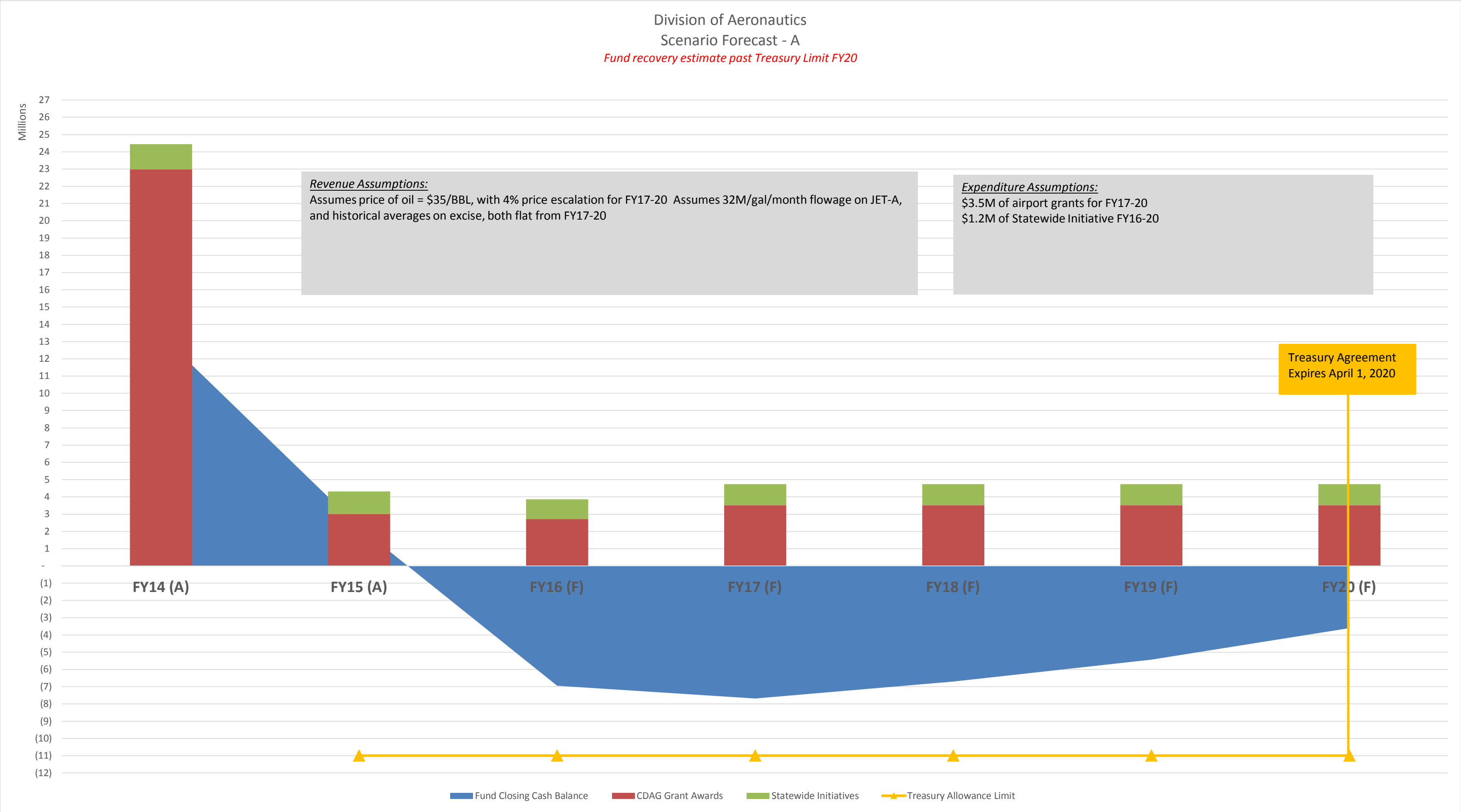
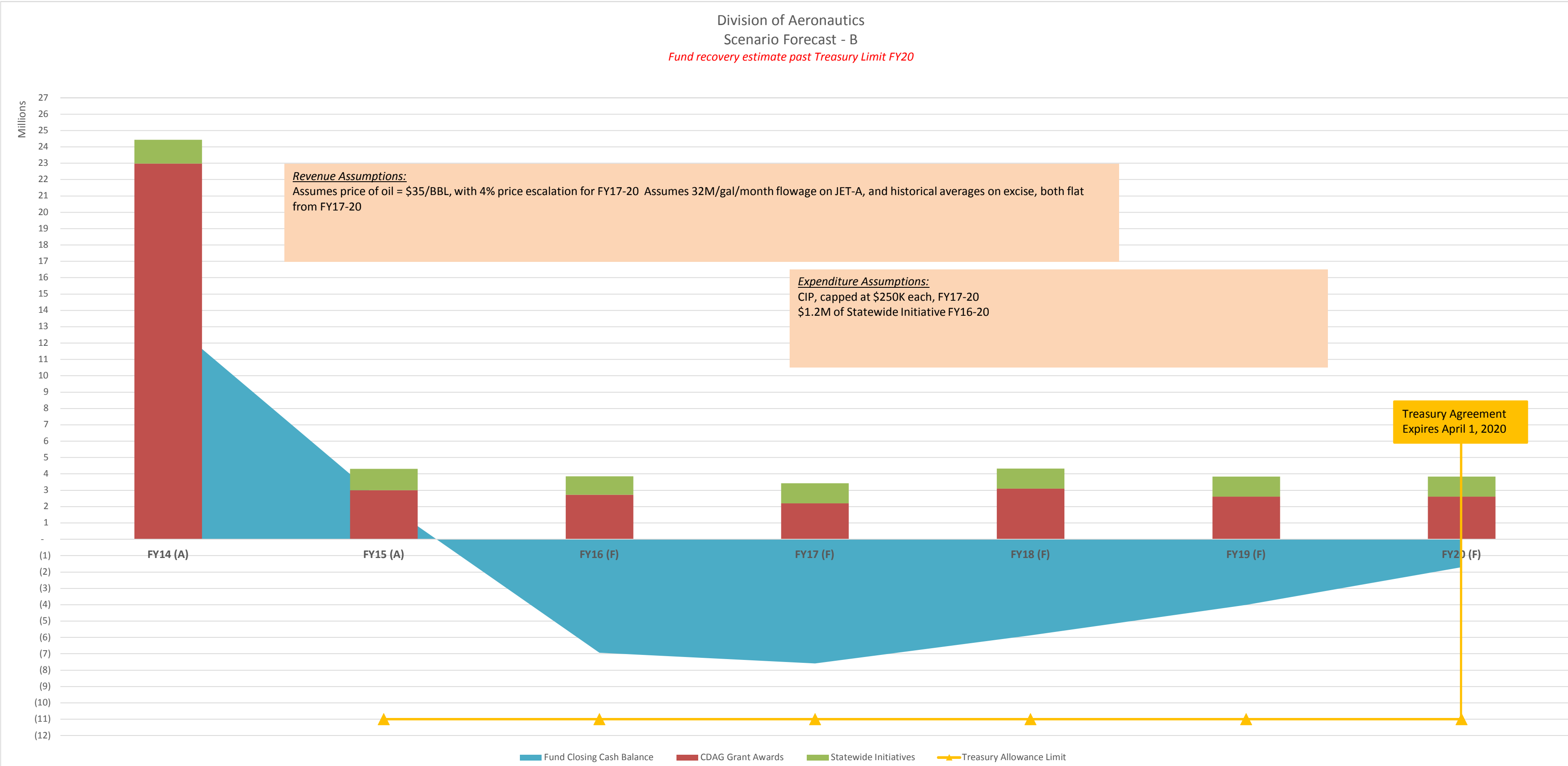
Jet Fuel Spot Price/gal
Cushing, OK WTI Spot Price FOB (Dollars per Barrel)



Scenario A	FY14 (A)	FY15 (A)	FY16 (F)	FY17 (F)	FY18 (F)	FY19 (F)	FY20 (F)
Fund Closing Cash Balance	13,377,913	2,246,993	(6,950,140)	(7,680,183)	(6,709,628)	(5,438,119)	(3,607,771)
CDAG Grant Awards	22,974,000	2,995,981	2,711,447	3,500,000	3,500,000	3,500,000	3,500,000
Administrative Expense	1,004,905	1,083,715	1,104,375	972,237	888,655	1,038,032	1,084,853
Fuel Refunds to Airports	24,229,047	20,413,602	13,200,000	11,960,000	13,940,000	14,580,000	15,080,000
Statewide Initiatives	1,455,000	1,304,805	1,136,901	1,224,000	1,224,000	1,224,000	1,224,000
Treasury Allowance Limit		(11,000,000)	(11,000,000)	(11,000,000)	(11,000,000)	(11,000,000)	(11,000,000)
Estimated Revenue	35,343,226	31,593,000	19,444,747	17,773,097	20,760,639	21,697,067	22,455,477

** Administrative Budget NTE 5% of prior FY Revenue*
** (A) denotes Actual amounts; (F) denotes Forecasted amounts*

For Internal Aeronautics Division Discussion Purposes Only



Scenario B	FY14 (A)	FY15 (A)	FY16 (F)	FY17 (F)	FY18 (F)	FY19 (F)	FY20 (F)
Fund Closing Cash Balance	13,377,913	2,246,993	(6,950,140)	(7,602,183)	(5,879,628)	(4,018,119)	(1,715,828)
CDAG Grant Awards	22,974,000	2,995,981	2,711,447	2,200,000	3,100,000	2,600,000	2,600,000
Administrative Expense	1,004,905	1,083,715	1,104,375	972,237	888,655	1,038,032	1,084,853
Fuel Refunds to Airports	24,229,047	20,413,602	13,200,000	11,960,000	13,940,000	14,580,000	15,080,000
Statewide Initiatives	1,455,000	1,304,805	1,136,901	1,224,000	1,224,000	1,224,000	1,224,000
Treasury Allowance Limit		(11,000,000)	(11,000,000)	(11,000,000)	(11,000,000)	(11,000,000)	(11,000,000)
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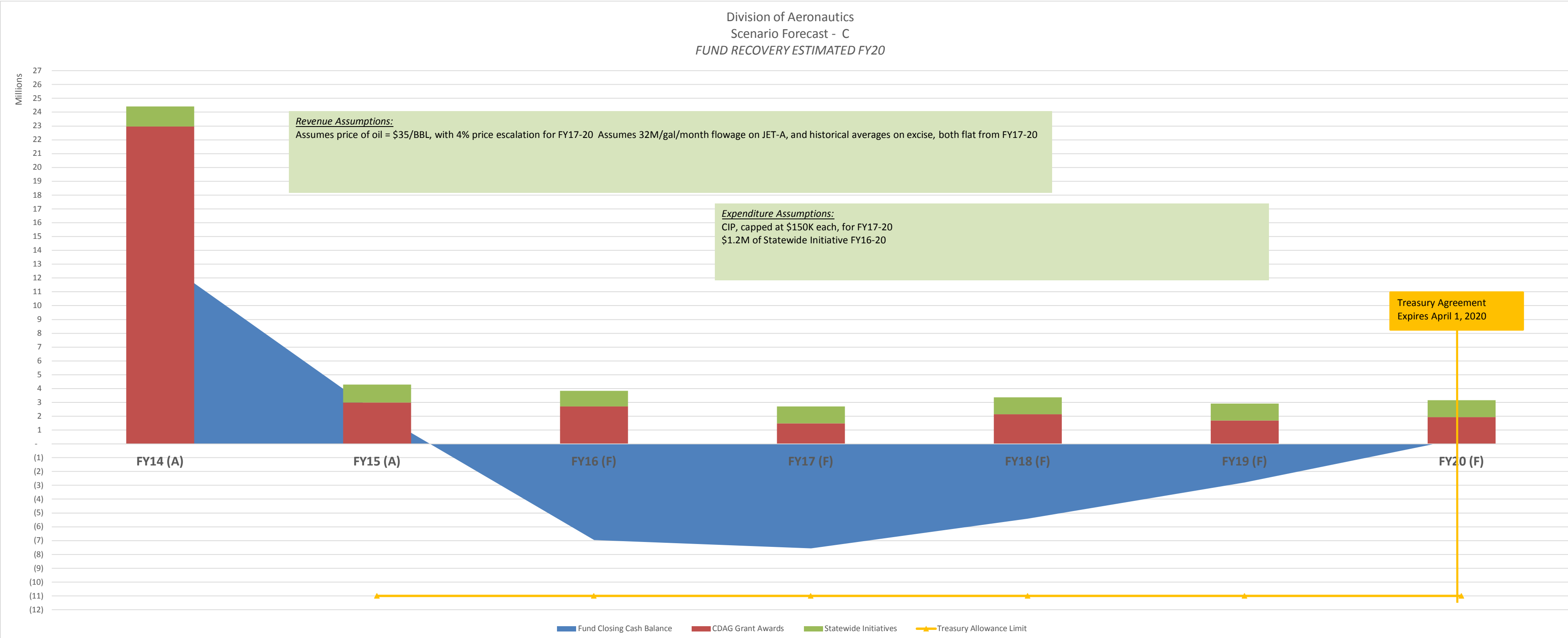

Scenario C	FY14 (A)	FY15 (A)	FY16 (F)	FY17 (F)	FY18 (F)	FY19 (F)	FY20 (F)
Fund Closing Cash Balance	13,377,913	2,246,993	(6,950,140)	(7,559,324)	(5,398,565)	(2,781,531)	390,437
Administrative Expense	1,004,905	1,083,715	1,104,375	972,237	888,655	1,038,032	1,084,853
Fuel Refunds to Airports	24,229,047	20,413,602	13,200,000	11,960,000	13,940,000	14,580,000	15,080,000
CDAG Grant Awards	22,974,000	2,995,981	2,711,447	1,485,685	2,153,829	1,696,107	1,940,690
Statewide Initiatives	1,455,000	1,304,805	1,136,901	1,224,000	1,224,000	1,224,000	1,224,000
Treasury Allowance Limit		(11,000,000)	(11,000,000)	(11,000,000)	(11,000,000)	(11,000,000)	(11,000,000)
Estimated Revenue*	35,343,226	31,593,000	19,444,747	17,773,097	20,760,639	21,697,067	22,455,477

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