



# OFFICE OF INTERNAL AUDIT

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## REPORT TO THE BOARD OF SUPERVISORS

### AIRPORT ECONOMIC DEVELOPMENT DEPARTMENT AUDIT

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## TABLE OF CONTENTS

Executive Summary	3
Overall Conclusion	3
Audit Scope and Methodology	6
Background	7
 <u>Audit Findings and Recommendations</u>	
<i>A.</i> AED billing and account receivable process	10
▪ Recommendation 1 and 2	11
<i>B.</i> Tenant Compliance with lease insurance requirement	11
▪ Recommendation 3	12
<i>C.</i> Non-compliance with original quitclaim deed	13
▪ Recommendation 4	15
<i>D.</i> Oversight of Pinal Airpark property	16
▪ Recommendation 5 and 6	20
<i>E.</i> San Manuel Airport operations	20
▪ Recommendation 7 and 8	21
 APPENDIX A	 22

Attachment: Management Response and Action Plan

## **Executive Summary**

The Pinal County Office of Internal Audit has completed an audit of the Pinal County Public Works Department's Airport Economic Development Department (AED) as part of our FY 2011/2012 Annual Audit Plan approved by the Pinal County Board of Supervisors.

The audit was planned and conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS). These standards require we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.

The objectives of our audit were to:

- Obtain an understanding of the Airport Economic Development Department operations.
- Determine if policies and procedures are conducted in compliance with applicable federal and state statutes.
- Compare Pinal County Airport Economic Development operations with similar selected programs and analyze for best practices and most efficient use of resources.

## **Overall Conclusion**

Our overall conclusion is the Airport Economic Development (AED) Department needs a more proactive approach to airport facilities management. During our review, we identified the following potential opportunities for increased efficiency and effectiveness within the Airport Economic Development Department:

- 1. *The AED Director should, upon seeking legal advice, notify Evergreen Maintenance Center, Inc., in writing, of the amount of past due uncollected rent and the correct current lease payment amount.***

*Defining grounds for termination, Section 16.1.1.3 of the lease agreement states, "Failure by Tenant to make any payment of rent, as and when due, where such failure shall continue for a period of thirty (30) days after written notice thereof by Pinal to Tenant."*

- 2. *The AED Director should establish a formal billing process, to ensure accurate and timely processing of lease payments. The process should include a requirement to annually compute the lease payment according to the requirements in section 4.3 – 4.3.2 of the lease.***

- 3. *The AED Director should develop procedures to:***

- *Verify Pinal Airpark tenants maintain required insurance coverage and retain substantiation on file.*
- *Require regular inspection of leased property and maintain a current property inventory and condition report.*
- *Determine when, and how, a tenant is required to repair or replace damaged property.*

- *Require airport tenants to immediately notify Pinal County when any change of ownership occurs and provide proof of updated insurance coverage under new ownership.*
- 4. *The AED Director, in conjunction with County Management and competent legal counsel, should seek to renegotiate the Airpark lease to release the County from any lease provisions that are in violation of the Grant (Quitclaim Deed) restrictions. Appropriate renegotiation of the lease would prevent reversion of the property to the Federal government and allow the County to apply for AIP grants to help finance needed improvements. No new lease should be approved without the expressed written consent of the Federal Aviation Administration (FAA) per Deed restrictions, and a thorough legal review to verify the legality of all transactions.*
- 5. *Upon successful renegotiation of the lease approved by the FAA, the AED Director should initiate prudent and active management of the Pinal County Airpark facility that includes developing a current Airport Master Plan and a business/financial plan. The plans should include:*
  - *Establishing minimum operating standards;*
  - *Developing an analysis of comparable lease rates at comparable facilities;*
  - *Calculations of replacement value of assets when determining values for insurance;*
  - *Developing future capital improvement plans for the facility and surrounding area.*
  - *Establishing eligibility for public financing of improvements, such as federal and state grants and Industrial Development bonds;*
  - *Business opportunity costs lost or gained with current tenants*
  - *Establishing lease rates similar to comparable facilities*
- 6. *The Board of Supervisors should consider seeking a legal opinion concerning the appraisal of Airpark property and the possible inclusion of the value of leasehold improvements for tax purposes (IPR's); per State of Arizona Department of Revenue recommendation.*
- 7. *The AED Director should establish a facility business plan for the San Manuel Airport. A business plan should evaluate and plan for the needs of the operation in the present and in the future. An airport business plan should include:*
  - *Schedules for ground, facility and vehicle maintenance.*
  - *Supplies management.*
  - *Review and update of legal and regulatory concerns, including vendor contracts.*
  - *Site safety and security plans.*

- *Capital improvement program, including possible future products and services.*
8. *The AED Director should establish policies and procedures for proper business revenue management, including;*
- *Establish/ update all bank accounts to be consistent with current County policy;*
  - *Procedures for hangar rental and fuel sales billing, collections and deposits.*

We would like to thank the management and staff of the Pinal County Development Services Department and the Airport Economic Development Department for their assistance and cooperation during the course of this audit. The following report provides additional details of our audit observations and recommendations.

Lori Stripling  
Internal Audit Officer

## **Audit Scope and Methodology**

The scope of our audit was to determine if internal controls are adequate to ensure efficiency and effectiveness of operations, protection of assets, proper allocation and use of resources, and the achievement of departmental goals.

The following methodologies were used to complete the audit:

- Identified major risks and related mitigating controls for airport operations
- Reviewed department mission and goals
- Interviewed Airport Economic Development employees concerning operations
- Analyzed department budget and financial information
- Reviewed Airport Master Plans for San Manuel Airport and Pinal Airpark
- Reviewed the Pinal County Comprehensive Plan for Airport planning and development
- Reviewed tenant lease agreements for San Manuel Airport and Pinal Airpark
- Identified and tested compliance for lease agreements and asset management
- Conducted a compliance review of identified applicable federal and state statutes
- Examined environmental impact reports and obligating long and short-term compliance requirements
- Compared selected operations for best practices and most efficient use of resources

**Background**

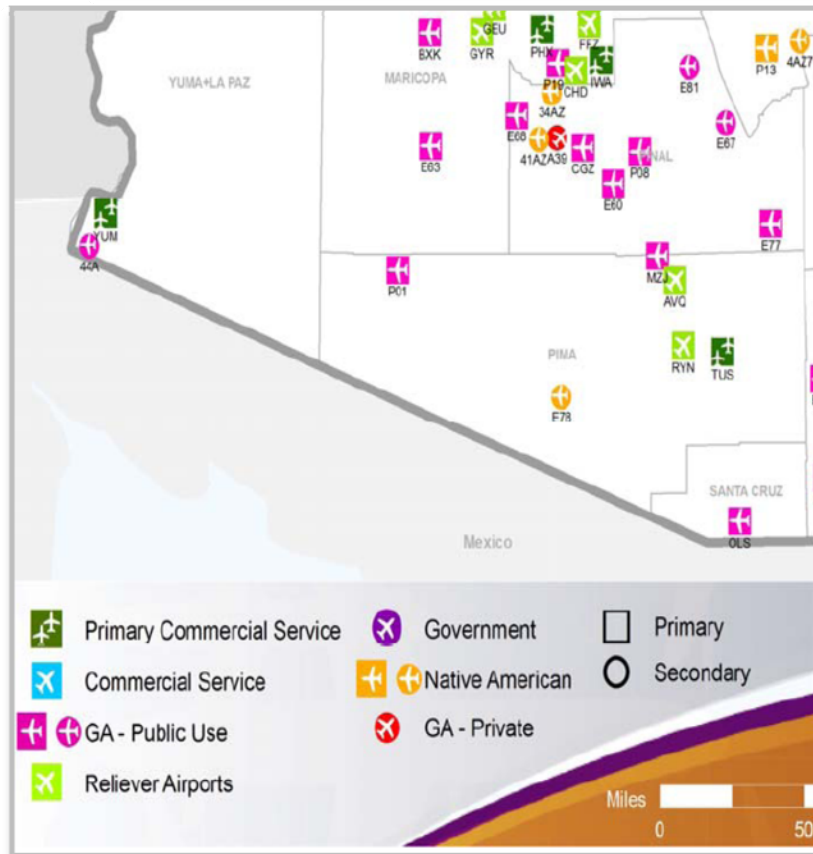
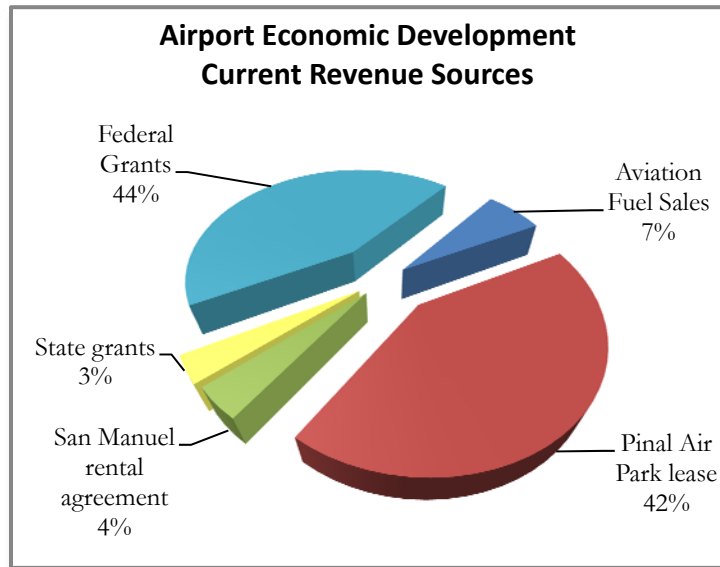
The Pinal County Airport Economic Development department (AED) was established in 2002 and is currently under the authority of the Public Works department. AED manages the San Manuel airport and has oversight for the Pinal Airpark.

The AED department employs one full-time Airport Economic Development Director and one part-time Airport Operating Assistant at the San Manuel airport.

Actual revenues for AED in FY 2010-2011 were \$762,562. The majority of revenues are federal and state grant funds. The remaining revenue is derived from aviation services and facility lease payments. Actual operation expenditures for FY 2010-2011 were \$701,705;<sup>1</sup> and AED currently maintains an unreserved fund balance of \$993,748.36<sup>2</sup>.

There are six National Plan of Integrated Airport Systems (NPIAS) general aviation airports in Pinal County; Casa Grande, Coolidge, Eloy, San Manuel and Superior airports; and the Pinal Airpark.

To be in the NPIAS an airport must: (1) be more than 30 miles from the closest NPIAS airport; two (2) have at least 10-based aircraft; and (3) have a willing public sponsor.



Airports included in NPIAS are eligible to receive federal funding from the Federal Aviation Administration (FAA) Airport Improvement Program (AIP).

<sup>1</sup> <http://www.pinalcountyyaz.gov/Departments/BudgetOffice/Documents/Downloads/Tentative%20Budget-%20Schedules%20A%20-%20K.pdf>

<sup>2</sup> 9/12/11

## Pinal Airpark – Marana

The Pinal Airpark (Airpark) is a county-owned airport located just north of the Pinal/Pima county line along Interstate 10. The airport was constructed in 1942 as a US Army Airfield (Marana Army Air Field) and used as part of a 50,000 pilot training program during World War II<sup>3</sup>. The original Airpark was approximately 2,080 acres of land and extensive infrastructure; including one asphalt runway measuring 6,850 by 150 feet; water, sewer, gas and a railroad spur line (the spur was later removed).

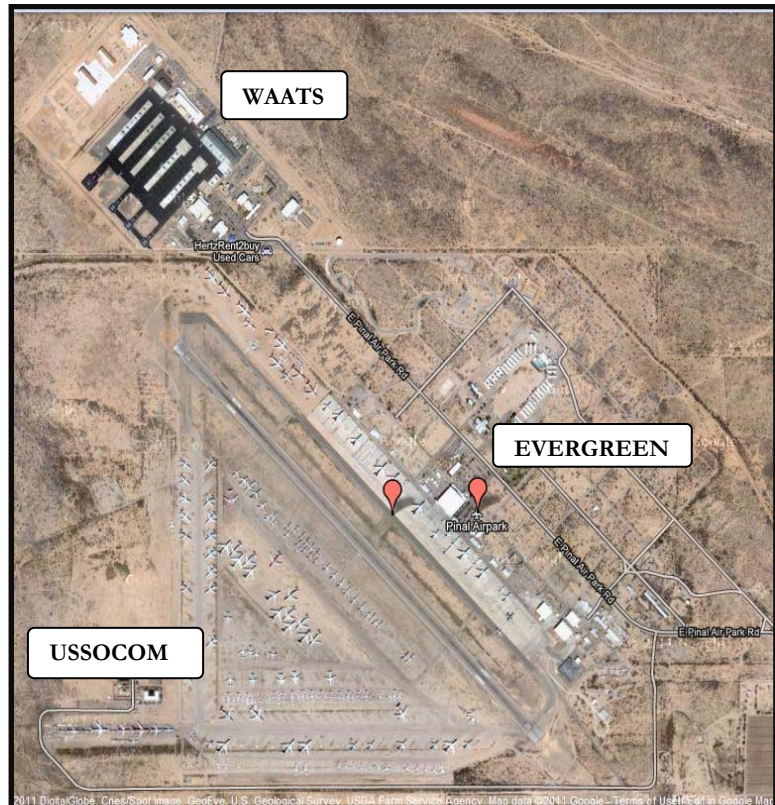
The airbase was closed in 1948 and Pinal County accepted a deed to the property on June 17, 1948.

In 1992, United States Special Operations Command (USSOCOM) bought four-hundred and eighty (480) acres of Airpark land in the southwest corner of the leased property for \$1,000,000.<sup>4</sup> The acquired property includes the use of the Airpark runway. USSOCOM operates a parachute training and testing facility on the site, and an expansion of these operations was recently approved by Congress.<sup>5</sup>

Just north of the Airpark is the Silverbell Army Helicopter Training Site (WAATS). The site is used for Apache (ARNG AH-64) helicopter training and military combat training operations.

The airspace north and west of Airpark property is designated as a low-level military flight-training route (MTR). MTR space is up to 10 miles wide and department of defense aircraft are allowed to conduct flights as low as 100 feet above ground level, at speeds in excess of 250 knots. Due to existing case law, MTR's cannot be relocated.<sup>6</sup>

NPIAS has designated the Airpark a general aviation/community airport; however, due to near-by military training operations and an exclusive lease with Evergreen Air Center, Inc. (Evergreen), general aviation operations are constrained.



<sup>3</sup> [http://en.wikipedia.org/wiki/Pinal\\_Airpark](http://en.wikipedia.org/wiki/Pinal_Airpark)

<sup>4</sup> Without FAA approval (FAA 2008 AIP Annual Report of Accomplishments)

<sup>5</sup> <http://giffords.house.gov/SOF%201391.pdf>

<sup>6</sup> Governor's Military Affairs Commission La Oso  
Briefing April 4, 2006

## **San Manuel Airport**

In 1944, Magma Copper Company purchased an existing mining claim and established the town of San Manuel to house company workers. In 1953, Pinal County constructed San Manuel Airport, a 4,200-foot gravel airstrip for public use, on Magma Copper land.

In 1967, an agreement between Pinal County and Magma Copper Company was approved to allow the County to formally lease the fifty-four (54) acres of land at the airport for a period of twenty (20) years and, in 1983, the lease was extended to 2010. In 1995, the lease was renegotiated for an additional thirty-five (35) years.



The new lease allowed development rights and a revision to the dissolution clause that allowed only Pinal County the right to dissolve the agreement. This clause was necessary to allow Pinal County to apply for Airport Improvement Program (AIP) grants;<sup>7</sup> to obtain government grant money to further develop the San Manuel Airport property.

Currently, the leased land is owned by the BHP Billiton Mining Company. BHP closed the San Manuel mine in 2002, and the town experienced an 18.8% decrease in growth from 2000 to 2010.<sup>8</sup>

The airport is currently used for recreational public use, medical transport, and as a forest fire-fighting support and aircraft staging area.

<sup>7</sup> <http://www.faa.gov/airports/aip/>

<sup>8</sup> <http://www.cubitplanning.com/city/18549-san-manuel-cdp-census-2010-population>

## Audit Findings and Recommendations

### A. AED Billing and Accounts Receivable Process

In 1982, Pinal County signed an exclusive lease with Evergreen Maintenance Center Inc. (Evergreen) for twenty-five (25) years ending on August 15, 2007. In 1990, Arizona state statutes were changed to allow a twenty-five (25) year extension of an existing airport lease without a public bid requirement; and in 1992, the lease was extended until August 15, 2032.

In 1999, this same Arizona state statute (ARS 28-8425) was amended to allow a forty-year (40) lease extension; however, at this time, Pinal County has not renegotiated the lease to allow a forty-year extension to 2047.

Section 4.3 through 4.3.2 of the current lease requires annual adjustments to the lease payment amount. Internal Audit reviewed AED procedures for Pinal Airpark lease payments and found:

- The AED department, established in 2002, had never adjusted the lease payments prior to 2011. Further, Internal Audit determined lease payments have not been adjusted, as required,<sup>9</sup> since 1999. The total adjusted uncollected revenue owed to Pinal County is **\$741,167.23** (See details in the table below).
- AED has not established leasing procedures that include billing and receiving quarterly payments or adjusting annual payments. AED advised Evergreen Air Center, Inc., by letter on March 17, 2011, of a change in the lease payment for the 2011/12 contract year; however, the amount calculated (\$93,180.31) was not accurate. The current quarterly lease payment should be \$121,977.16.

Year	Amount Collected	Prior year plus 1 + CPI	Amount should have collected	Difference
1999	\$368,301.64	1.013	\$373,089.56	\$4,787.92
2000	\$368,301.64	1.020	\$380,551.35	\$12,249.71
2001	\$368,301.64	1.039	\$395,392.86	\$27,091.22
2002	\$368,301.64	1.019	\$402,905.32	\$34,603.68
2003	\$368,301.64	1.017	\$409,754.71	\$41,453.07
2004	\$368,301.64	1.019	\$417,540.05	\$49,238.41
2005	\$368,301.64	1.030	\$430,066.25	\$61,764.61
2006	\$368,301.64	1.028	\$442,108.11	\$73,806.47
2007	\$368,301.64	1.027	\$454,045.02	\$85,743.38
2008	\$368,301.64	1.040	\$472,206.83	\$103,905.19
2009	\$368,301.64	1.000	\$472,206.83	\$103,905.19
2010	\$368,301.64	1.021	\$482,123.17	\$113,821.53
2011 first quarter payment	\$93,180.31	1.012	\$121,977.16	\$28,796.85
<b>Total uncollected amount</b>				<b>\$741,167.23<sup>10</sup></b>

<sup>9</sup> Adjusted annually, "...for a sum of one (1.0) plus an Escalator Factor (CPI).

<sup>10</sup> If the quarterly rate collected for the 2011/2012 contract year is not corrected to \$121,977.16 the total amount of uncollected rent at the end of the contract year will be \$827,557.78

### **Recommendation**

- 1. The AED Director should, upon seeking legal advice, notify Evergreen Maintenance Center, Inc., in writing, of the amount of past due uncollected rent and the correct current lease payment amount.***

*Defining grounds for termination, Section 16.1.1.3 of the lease agreement states, "Failure by Tenant to make any payment of rent, as and when due, where such failure shall continue for a period of thirty (30) days after written notice thereof by Pinal to Tenant."*

- 2. The AED Director should establish a formal billing process, to ensure accurate and timely processing of lease payments. The process should include a requirement to annually compute the lease payment according to the requirements in section 4.3 – 4.3.2 of the lease.***

### **B. Tenant Compliance with Lease Insurance Requirements**

The Airport Economic Development Director has not developed a verification process to determine if the Pinal Airpark tenant maintains required insurance coverage.

Section 21.2, added in the second lease amendment<sup>11</sup>, requires the Tenant to carry liability insurance naming Pinal as second insured. In July, 2011, Internal Audit staff requested a current copy of insurance to confirm compliance with this requirement. The AED Director provided a Certification of Insurance, dated April 1, 2011, naming Evergreen International Aviation, Inc. (the parent company of the tenant) as Insured and Pinal County as Additional Insured.

Internal Audit confirmed Evergreen International Aviation, Inc. sold the Pinal Airpark maintenance center operation to Relativity Capital on May 31, 2011. (See press release, Appendix A). Internal Audit discussed the sale with the Pinal County Risk Manager and it was suggested an updated Certificate of Insurance, naming Evergreen Maintenance Center as insured, was needed for required insurance coverage. Internal Audit asked for, and received, an updated certificate of liability insurance document, dated August 9, 2011, naming Evergreen Maintenance Center, Inc. as insured, and Pinal County as additional insured. The delayed date on this document *may* indicate a lapse in liability insurance coverage from May 31, 2011 to August 9, 2011, occurred.

Also, section 8.2 of the Pinal Airpark lease requires the Airpark Tenant (Evergreen) to carry comprehensive all-risk insurance with limits no less than replacement value of all buildings and improvements on the premises. Internal Audit was not able to obtain evidence of the Airpark tenant's property insurance. To verify proper insurance coverage, the AED Director should retain current copies of all insurance documents, for both liability and property.

Additionally, Section 8.2 states, "In the event of damage or destruction of any building or other facility on the premises by fire, wind, water or other causes....Tenant agrees to repair such damage

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<sup>11</sup> 2<sup>nd</sup> amendment to lease entered into on July 1, 1998

or replace such destroyed buildings...in substantially the same form as they were prior to the destruction...” And, Section 21.1 of the second amendment to the lease states, “Tenant may use any and all fire equipment, including but not limited to a fire truck, stationed by Pinal at the leased premises...”

To determine compliance with these provisions Internal Audit asked the AED Director for a current condition and inventory report of all buildings and other assets at the Airpark, including the fire truck. The AED Director confirmed the department has never conducted an inspection of Airpark property to determine the existence and condition of inventory.

Internal Audit staff toured the Airpark and observed that many of the original buildings and facilities are still in use; however, we observed one building on the site had burned to the ground and the building had not been replaced. Checking area news accounts,<sup>12</sup> we determined the fire occurred on Tuesday, July 15, 2008.



During the tour, Internal Audit also asked about the fire truck mentioned in the second lease amendment. The long-time Airport Facilities Director employed by the Airpark tenant explained the Pinal County fire truck was no longer in use and was stored in a salvage area on the property. He also mentioned the theatre, listed in the 1982 lease inventory, is now gone.



Basic property management should include a periodic tour of leased property and the required use of inventory and condition reports for all County property.

### **Recommendation**

#### ***3. The AED Director should develop procedures to:***

- ***Verify Pinal Airpark tenants maintain required insurance coverage and retain substantiation on file.***
- ***Require regular inspection of leased property and maintain a current property inventory and condition report.***
- ***Determine when, and how, a tenant is required to repair or replace damaged property.***
- ***Require airport tenants to immediately notify Pinal County when any change of ownership occurs and provide proof of updated insurance coverage under new ownership.***

<sup>12</sup> <http://www.azcentral.com/community/pinal/articles/2008/07/16/20080716gr-fire0716.html>

### **C. Non-Compliance with Original Quitclaim Deed for Pinal Airpark Property**

Pinal County entered into a lease with the current tenant allowing *exclusive* use of the Pinal Airpark property, which is in direct violation of the original Quitclaim Deed. This action could result in reversion of the property to the Federal Aviation Administration (FAA).

On June 17, 1948, the United States War Assets Administration office conveyed a Quitclaim deed for the Marana Army Air Field to Pinal County; now known as the Pinal County Airpark. The Deed included 2,080 acres of land and all “buildings, structures, and improvements,” and “all roads, easements, public utilities, railways and pipelines.” Acceptance of the deed was subject to the following two (2) restrictions:

1. The property “shall be used for public airport purposes, for the use and benefit of the public, on reasonable terms and without grant of exercise of any “**exclusive right**” for use of the **airport**.”
2. “...the entire landing area, and all structures, improvements, facilities and equipment transferred (in this deed) shall be maintained for the use and benefit of the public...”

The document further defined **airport** as, “all such land, buildings, structures, improvements and equipment,” and, **exclusive right** as the (1) right to use the airport for conducting any particular aeronautical activity requiring operation of aircraft; and, (2) right to engage in the sale or supplying of aircraft, aircraft accessories, equipment or supplies (excluding gasoline and oil), or aircraft services necessary for the operation of aircraft (including the maintenance and repair of aircraft, aircraft engines, propellers or appliances).

There is significant documentation to substantiate the FAA believes Pinal County has violated these Deed restrictions.

In 1993 Pinal County applied for Federal financial grants, under the Airport Improvement Program (AIP), to help maintain the Pinal Airpark facility. The Federal Aviation Administration (FAA) declined the grant request and, in the first of several letters over the next twelve (12) years, responded by stating they were, “... concerned with the County’s ability to comply with the prohibition against granting of an exclusive right...” and believed, “... certain paragraphs in the lease hinder the County’s abilities to meet (grant) obligations.” Some of the particular paragraphs cited<sup>13</sup> include:

**Airpark lease; paragraph 3.2.15 – The tenant may prohibit or limit any given type, kind or class of aeronautical use of the airport when and if such action is necessary for the safe operation of the airport or to serve the civil aviation needs of the public.**

The FAA stated, “The unconditional delegation of this authority to a tenant ... would be a serious conflict of interest and would be contrary to (the) Grant (Deed).”

All entry into the property is restricted by the current tenant. Internal Audit staff attempted to enter the Airpark to tour the property and could not enter without stopping at the gated entrance

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<sup>13</sup> September 21, 2003 letter from Robert Bloom, (FAA) to Brad Gair (Pinal County Civil Works)

operated by an employee of the current tenant. Audit staff was allowed entry to the property only after obtaining an escort by an employee of the current tenant, for our entire property tour.

Following Internal Audit staff's visit, the AED Director received an admonishing email from the current tenant management citing our visit and referring to section 22.12 of the lease that states Airpark entry must be, "...executed in a manner that does not interfere with the conduct of Tenant business."

**Airpark lease; paragraph 4.5 – "...the rent shall not be related in any way to the value of the Airpark. Furthermore, rent shall not be related in any way to Tenant's revenue or receipts. Notwithstanding anything to the contrary, Tenant shall receive all proceeds from sublease rental, storage rental, fuel sales, and all other revenues; Tenant shall use and apply all proceeds according to its own discretion; and Tenant shall not pay a premium, surcharge, or commission thereon."**

The FAA stated, "This paragraph would hinder the County's ability to establish and maintain a fee and rental structure in accordance with the requirements of the Grant (Deed)."

Internal Audit's limited research of documents about Tenant operations revealed revenue from operations is in the millions of dollars, and the Airpark property has been used to secure substantial leasehold mortgages. Section 9.4.10 of the lease allows, "Tenant and every successor tenant shall be permitted to execute separate leasehold mortgages to encumber separate portions or parcels of the Premises." Section 9.5.1 of the lease requires, "Following execution of this Lease, Pinal shall execute and deliver a Collateral Assignment of Lease in a form as required by mortgagee." Internal Audit reviewed a document dated May 18, 1999, signed by the former Pinal County Manager and addressed to the "Collateral Agent." There was no signature indicating a legal review or Board approval of the document.

**Airpark lease; paragraph 7 – The Tenant shall at tenant's sole cost and expense, keep the Airpark in good condition and repair. The County shall have no obligation whatsoever to maintain, restore, or repair the Airpark during the term of the lease."**

The FAA stated, "This paragraph raises questions regarding the County's use of revenue generated by the airport in accordance with the Grant (Deed)."

Airpark lease payments have been used to pay for the cost of the Airport Economic Development department since its inception in 2002. Any excess revenue generated by airport operations has been retained in the fund balance. Prior to 2002, lease payments were applied to the County general fund<sup>14</sup>.

**Airpark lease; paragraph 10.2 – The Tenant may enter into any subcontract, sublease, or other agreement with any person, entity or organization...for the use or occupancy of the Airpark or any part thereof without the consent of the County..."**

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<sup>14</sup> GF 1025.35301

The FAA stated, “Since all available property is leased to the Tenant any prospective fixed base operator (FBO) would be required to negotiate a sublease with The Tenant. Under the Grant (Deed) the County may not delegate its authority to the Tenant to negotiate an operating or lease agreement with another FBO.”

In the 2008 FAA 25<sup>th</sup> Annual Report to Congress for Airport Improvement Program grants, the FAA listed Pinal Airpark compliance status as “Non-Compliant” and stated, “The entire airport was leased to a private company in violation of the applicable Surplus Property Agreement. The Airport is not open to the public.” And, under corrective action, “Sponsor must renegotiate lease with operator and address all outstanding compliance violations.”

The Deed also includes seven (7) reservations. Reservation six (6) states, “No property transferred by this instrument shall be used, leased, sold, salvaged or disposed of by the GRANTEE ...without the written consent of the Civil Aeronautics Administrator...”<sup>15</sup>

There is no documentation to demonstrate Pinal County obtained the written consent of the Civil Aeronautics Administration, now the Federal Aviation Administration (FAA), for the current airport lease.

### **Federal Government Right of Reversion**

Page five (5) of the Airpark Quitclaim Deed states, “In the event that any of the aforesaid reservations or restrictions are not met, observed or complied with by the Grantee, whether caused by legal inability or otherwise; shall, at the option of the Grantor, revert to the United States sixty (60) days following the date upon which demand is made by the Civil Aeronautics Administrator.”

During the course of this audit Internal Audit contacted the FAA about the likelihood of reversion for these Deed violations and was told,<sup>16</sup> “...reversion is likely the last recourse when all other corrective measures have failed...a few reversions have occurred in the past, including one in 2009.”

Given the fact that correspondence with the FAA has been ongoing since 1993; and Pinal County has not corrected the Deed violations cited by the FAA, it is reasonable to presume the FAA will consider reversion of the Grant (Deed) property to resolve these issues within a progressively concise timeframe.

### **Recommendation**

- 4. The AED Director, in conjunction with County Management and competent legal counsel, should seek to renegotiate the Airpark lease to release the County from any lease provisions that are in violation of the Grant (Quitclaim Deed) restrictions. Appropriate renegotiation of the lease would prevent reversion of the property to the Federal government and allow the County to apply for AIP grants to help finance needed improvements. No new lease should be approved without the expressed written consent of the FAA, per Deed***

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<sup>15</sup> The Civil Aeronautics Administration is now the Federal Aviation Administration (FAA).

<sup>16</sup> Email to Internal Audit staff from Anthony Garcia (FAA) July 7, 2011

*restrictions, and a thorough legal review to verify the legality of all transactions.*

#### **D. Oversight of the Pinal County Airpark Property**

The Pinal County Airport Economic Development Department has failed to maintain prudent and active oversight of the Pinal County Airpark property.

Paragraph seven (7) in the lease states, “The County shall have no obligation whatsoever to maintain, restore, or repair the Airpark during the term of the lease.” Notwithstanding this lease restriction, Pinal County has not maintained prudent, and active, oversight of this multi-million dollar county asset. Establishing basic operating standards, such as minimum runway lighting, maximum landing weights and required pavement condition indicator scores would help ensure judicious tenant use of Airpark resources.

During the course of this audit, Internal Audit assessed current property condition and noted the following:

- Internal Audit found the last Pinal Airpark Master Plan (ALP), developed in 1990, estimated the cost to develop the Pinal Airpark would total “slightly more than \$35 million by the year 2011.” Recommended improvements to the property were never accomplished and the costs do not include current development and infrastructure issues; such as, deteriorated runway condition and management of the new sewage lagoon constructed on the site by the Army Corp of Engineers. A new facility master plan would be needed to apply for any Federal grant assistance.
- A Pima Association of Government Regional Airport System Plan (RASP) study conducted in 2002 made the following recommendations for the Pinal Airpark:
  - Pavement condition should be improved to meet a PCI rating of 80
  - Master plan should be updated/developed
  - A business/financial plan should be developed and property values established
  - Rates and charges should be updated
  - Minimum standards should be established
  - Install high-intensity runway lights (HIRL) and medium-intensity taxi lights (MIRL)
  - A total of 41 additional hangars should be provided by 2030
  - A pilot lounge and rental car facility should be established on site
- On November 14, 2003, the Pinal County Manager received a letter from the Federal Aviation Administration listing eleven (11) recommended actions for consideration including: (f) Repair pavement, markings, and lighting as soon as possible, but no later than December 15, 2003; (h) Establish minimum standards; (k) Establish and implement a fee structure based on fair market values.

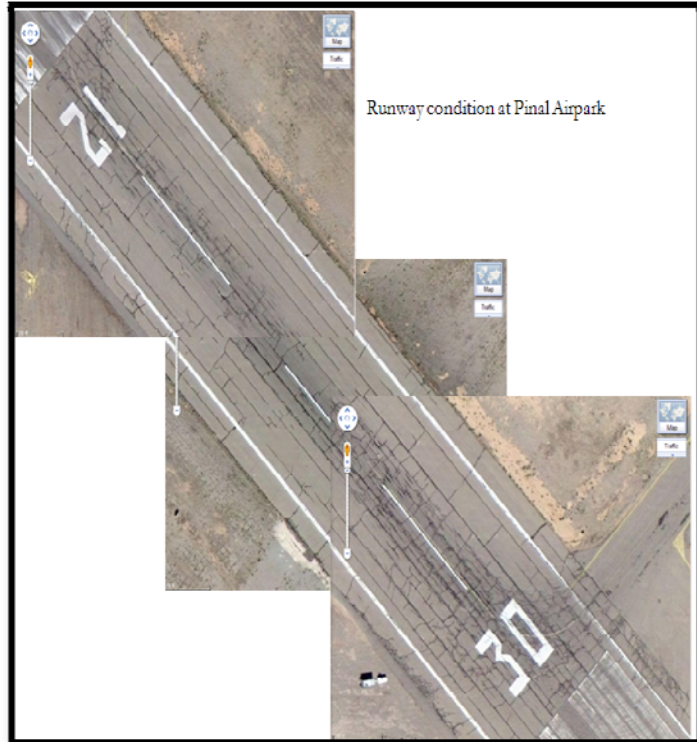
- Runway lighting at the Airpark is still mostly the original lighting installed in the 1940's. It is likely, maintenance skills and replacement parts for the lighting system are increasingly difficult to obtain. The RASP study estimated needed High-Intensity runway lights (HIRL) and Medium Intensity taxiway way lights (MITL) would cost \$1,986,500. Adjusted for inflation the cost would be \$2,470,213 today.




- A 2010 Department of Transportation Arizona Pavement Management System (APMS) report<sup>17</sup> stated the Pavement Condition Indicator (PCI) score for the Airpark was 52 out of 100. Pavement allowed to deteriorate below a PCI of 40 will require costly reconstruction to restore it to operational condition.<sup>18</sup>

- The RASP study estimated the cost to improve pavement condition to an 80 PCI score would be \$2,568,750. Using an accumulated adjusted rate of inflation (24.35%) the cost would be \$3,194,240.63 in 2011.

- The APMS report also concluded 71% of the deteriorated pavement condition was due to load. The empty operating weight for a 747 aircraft is 397,100 lb. and, it has been publically reported, the current tenant has operated a 747 aircraft super tanker on the Pinal Airpark runway.

- A Key Performance Indicator (KPI) for the Pinal County Performance Management program for the Airport Economic Development department is "100% of the time the Runway Pavement Grade is C (PCI =72) or above for 8 quarters." This KPI has not been met for the Pinal Airpark runway pavement.<sup>19</sup>



PCI	Representative Pavement Surface	Repair Alternative
96		Pavements with PCI values above a 60 to 70 often benefit from cost-effective preventive maintenance actions, such as crack sealing and surface treatments.
60		Pavements with a PCI in the range of 40 to 70 will typically require more expensive rehabilitation, such as an overlay.
5		Pavement allowed to deteriorate below a PCI of 40 may require costly reconstruction to restore it to operational condition.

<sup>17</sup> [http://www.azdot.gov/mpd/PDF/AZ\\_APMS\\_Summary\\_Report\\_2010.pdf](http://www.azdot.gov/mpd/PDF/AZ_APMS_Summary_Report_2010.pdf)

<sup>18</sup> FAA advisory 150/5380-6A

<sup>19</sup> This KPI may have been an indicator for the San Manuel runway grade only.

The RASP plan also noted Pinal County has never developed a business/financial plan. A business plan allows a business to assess challenges, allocate resources prudently, and maximize opportunities. A financial plan developed for the Pinal Airpark could also include an analysis of opportunity costs lost or gained by allowing exclusive use of the entire facility to one tenant.

In 2005, Kimley-Horn and Associates prepared a limited business plan for the Pinal Airpark tenant, including a study of land lease rates and hangar rental at other Arizona airports. The plan recommended, “(The current Pinal Airpark Tenant) should lease all area made available for its exclusive use (at the Airpark) and pay rental<sup>20</sup> for the entire area leased including automobile area, apron areas, the land underlying buildings and any other area exclusively leased such as a fuel farm.” The study stated ground lease rates should be about 10% of market value, but should usually fall in the 6-12% range. Rates for the airports included in the study ranged from \$0.06 to 0.13 per square foot for unimproved land and \$0.12 to \$0.25 for improved land.

Internal Audit performed a limited review of comparable airport facilities in Arizona and found the lease rate at the Pinal Airpark was significantly lower than similar facilities in Pinal County.

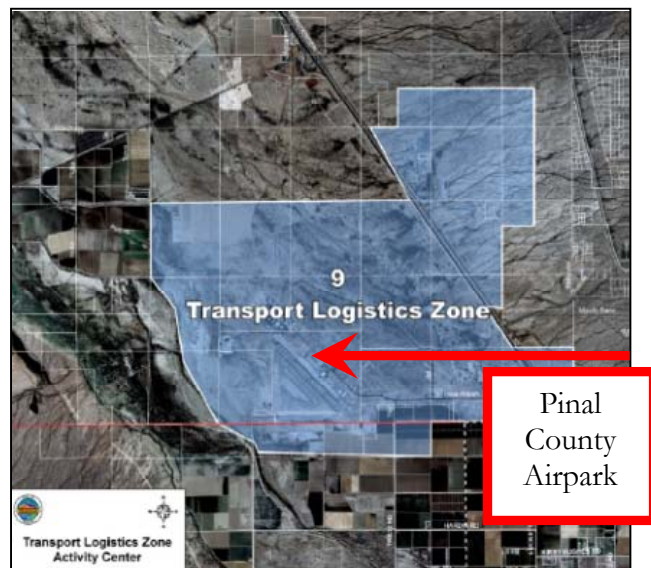
FACILITY	LEASE RATE PER SQUARE FOOT
Pinal Airpark	\$0.008
Casa Grande Airport	\$0 .20
Chandler Airport	\$0.067 – \$0.158

The recommended annual ground rental rates for Pinal Airpark in the Kimley-Horn study were, “...\$0.10 per square foot for unimproved land and \$0.20 per square foot for improved land.”

Using the lowest recommended rate for the Pinal Airpark (\$0.10 for unimproved land) and applying the rate to all land at the Airpark facility, the annual lease rate for the Airpark would be \$4,782,888.<sup>21</sup> The annual lease rate Pinal County currently charges for the facility is \$368,301, or \$.008 per square foot.

A comprehensive business /financial plan could also include future plans for the facility. Marana, a town near the Airpark, released a report in 2010 that concluded the area surrounding the Pinal County Airpark, “...provides tremendous opportunities for intermodal transportation, logistics, and freight activity.”

At a recent meeting, the town manager remarked “...planners envision an inland shipping and distribution center...” and stated the Airpark and a proposed Union Pacific Railroad switching yard just north of the Airpark, could spark “a powerhouse of industry that would transform the entire region.”



<sup>20</sup> This rate may be used to calculate lease payment made to the tenant’s parent company for accounting & tax purposes

<sup>21</sup> 1098 acres times 43,560 sq. feet per acre = 47,828,880 sq. ft times \$0.10 = \$4,782,888.

Objective 3.8.1<sup>22</sup> in the Pinal County Comprehensive Plan is to, “Develop the area as a sustainable employment center that maximizes the strategic multimodal location. This process has already begun and further development could be enhanced through the increased use of Federal and State grants, and Pinal County Industrial Development Authority bonds.

The RASP study also mentioned the Pinal Airpark “has not had a recent appraisal.” There has been no public bid on the property lease since 1971; however, there was an appraisal conducted at the beginning of the existing lease on July 12, 1982. Based on the appraisal,<sup>23</sup> the value of the land was \$2,080,000, and the buildings and improvements were valued at \$6,000,000.

The real property is tax-exempt; however, the current Airpark tenant, Evergreen Maintenance Center, is required to file an annual business personal property (BPP) tax return with the County Assessor. Internal Audit reviewed Business Personal Property statements filed by Evergreen for the Airpark property and found:

- Evergreen reported BPP valued at \$1,859,352 in 2010, and paid a total of \$51,331 in taxes
- The statements did not include any value for improvements on possessory right (IPR’s)

According to the Arizona Department of Revenue Business Property Statement guide, “Business Personal Property” (BPP) is identified as property used for commercial, industrial, and agricultural purposes. BPP may also include personal property improvements on possessory rights (IPR’s) and certain leasehold improvements.

IPR’s are buildings, structures, or other improvements located on land not owned by the owner of the improvements;<sup>24</sup> and may be located on either taxable or tax exempt land. Under Arizona law, the improvement value of the IPR should be calculated each year by the taxpayer and the County Assessor, and entered manually on the Personal Property Tax Roll.

During a property tour, Internal Audit noted many improvements to the Airpark property; including multi-million dollar aircraft hangars, and discussed the lack of reported IPR value on the leasee’s BPP statement with the Pinal County Assessor and State of Arizona Department of Revenue staff<sup>25</sup>.

The Assessor stated the leasehold improvements at the Airpark erected by Evergreen during the lease period were not subject to business personal property tax because the improvements, including large hangars, will become property of Pinal County at the end of the lease period.

The Department of Revenue staff stated, after reading the lease and discussing the possible impact of several recent court cases about these matters, there may be enough provisions in the lease to raise questions about the tax status of IPR’s on the property; and suggested Pinal County obtain a legal opinion from a tax attorney.

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<sup>22</sup><http://pinalcountyaz.gov/Departments/PlanningDevelopment/ComprehensivePlanUpdate/Documents/Pinal%20County%20Comprehensive%20Plan.pdf>

<sup>23</sup> Internal Audit contacted the County Assessor’s office and were told a 1992 appraisal was conducted but the office did not have a copy

<sup>24</sup> Except for certain goods and materials considered to be inventory and held for resale, and certain specified animals

<sup>25</sup> Supervisor of Locally Assessed Property

### Recommendation

5. *Upon successful renegotiation of the lease, approved by the FAA, the AED Director should initiate prudent and active management of the Pinal County Airpark facility that includes developing a current Airport Master Plan and a business/financial plan. The plans should include:*
  - *Establishing minimum operating standards;*
  - *Developing an analysis of comparable lease rates at comparable facilities;*
  - *Calculations for replacement value when determining values for insurance;*
  - *Developing future capital improvement plans for the facility and surrounding area.*
  - *Establishing eligibility for public financing of improvements, such as federal and state grants and Industrial Development bonds;*
  - *Business opportunity costs lost or gained with current tenants;*
  - *Establishing lease rates similar to comparable facilities.*
  
6. *The Board of Supervisors should consider seeking a legal opinion concerning the appraisal of Airpark property and the possible inclusion of the value of leasehold improvements for tax purposes (IPR's); per State of Arizona Department of Revenue recommendation.*

### E. San Manuel Airport Operations

Daily operations for the San Manuel airport are conducted by a full-time Airport Economic Development Director and a part-time Airport operations assistant. The Airport Economic Development Director has not developed a facility business plan, including policies and procedures, needed to effectively manage these functions.

Internal Audit reviewed business operations at the San Manuel Airport and found:

- There are no formal contracts with San Manuel facility vendors. AED management has not developed contracts with third party vendors offering services, such as flight lessons and aircraft maintenance.
- There are no formal procedures for fuel purchases, billing and collections. To pay for fuel purchases, AED opened two bank accounts. A merchant account was opened to facilitate credit card sales collections, and a checking account was opened to pay for fuel purchases. The accounts were established in violation of County Policy 8.05 *Establishing Bank Accounts*; which states, "The Treasurer shall keep all money belonging to the County in his (her) possession ..."

After a discussion with County Treasurer's office staff, Internal Audit determined the Treasurer's office could establish a merchant account for the purpose of allowing credit card payment for fuel

and automatically transfer funds directly from the merchant account into a county account, eliminating the need for a checking account.

- There are no formal procedures for hangar rental billing, collections and deposits. AED has started sending invoices for monthly hangar rentals; however, there are no policies for late payments and no process has been developed to inform Public Works of expected collection amounts.
- There are no formal procedures for renting out available aircraft hangars. Hangars were initially offered on a first come/first serve basis; however, there was no public announcement of available hangars and no random public selection process established. Also, management has not developed hangar waiting list procedures to verify actual hangar demand; such as, regularly updating lists, comparing list to surrounding airport lists, and establishing a level of commitment for hangar list participants, including cash deposits. The Aircraft Owners and Pilots Association have developed an Aircraft Hangar Development Guide to help with hangar management<sup>26</sup>.
- There are no formal security and incident procedures developed for the San Manuel Airport. Larger airports are required, under the Code of Federal Regulations, to adopt a security program. Smaller airports are not required to adopt a security program; however, it is a good public business practice to develop a security and incident plan. For example, Internal Audit learned the water tank on the San Manuel site is empty; reportedly due to holes in the tank, and there is no running water on site. These conditions should be considered when developing a site plan for emergency incidents. Emergency medical procedures should also be formalized.

### **Recommendation**

7. ***The AED Director should establish a facility business plan for the San Manuel Airport. A business plan should evaluate and plan for the needs of the operation in the present and in the future. An airport business plan should include:***
  - ***Schedules for ground, facility and vehicle maintenance.***
  - ***Supplies management.***
  - ***Review and update of legal and regulatory concerns, including vendor contracts.***
  - ***Site safety and security plans.***
  - ***Capital improvement program, including possible future products and services.***
8. ***The AED Director should establish policies and procedures for proper business revenue management, including;***
  - ***Establish/update all bank accounts to be consistent with current County policy;***
  - ***Formalize procedures for hangar rental and fuel sales billing, collections and deposits.***

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<sup>26</sup> <http://www.aopa.org/asn/hangar-planning.pdf>

# Appendix A

For Immediate Release  
May 31, 2011

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**RELATIVITY CAPITAL ACQUIRES EVERGREEN MAINTENANCE CENTER, INC.**

MARANA, AZ – Evergreen International Aviation, Inc. announced today an agreement with Relativity Capital L.P. to acquire the Evergreen Maintenance Center, Inc. (EMC). Based in Arizona, EMC is the largest aircraft storage and maintenance facility in the world with 20 million square feet of ramp and storage area that accommodates over 400 aircraft.

For more than three decades, EMC has been a FAA Approved FAR Part 145 repair station with a FAA Class IV Airframe Rate (#ERKR675D). In addition, EMC has been consistently recognized by the FAA with the esteemed Diamond Award and is a charter member of The Aircraft Fleet Recycling Association (AFRA), which is focused on improving substantially within the aircraft industry.

Evergreen International Aviation, Inc. Founder and Owner Delford M. Smith said, “We are pleased to have the opportunity to work with Relativity Capital. The Maintenance Center has an honest reputation for reliability. The management group and the maintenance team are true professionals, and Evergreen will continue to induct our 747s for heavy maintenance checks. We are excited about the future for the Maintenance Center and its team members.”

Relativity Co-Founder and Senior Managing Director, Joyce Johnson-Miller said: “EMC is an impressive organization with a proven track record for delivering quality aircraft maintenance and repair services to its customers. We are excited to be in partnership with the EMC management team and we are committed to continuing to support the company through its long-term growth.”

**About Evergreen International Aviation:**

Evergreen International Aviation, Inc. ([www.evergreenaviation.com](http://www.evergreenaviation.com)) is a portfolio of diverse aviation companies headquartered in McMinnville, OR. With international operating authority and a network of global offices and affiliates, Evergreen consists of an international cargo airline that owns and operates a fleet of Boeing 747s; a full-service helicopter company; an aircraft ground handling company; and an aircraft sales and leasing company. In addition to these endeavors, Evergreen owns and operates Evergreen Agricultural Enterprises.

**About Relativity:**

Relativity Capital ([www.relativitycapitalllc.com](http://www.relativitycapitalllc.com)), with offices in Arlington, VA, New York, NY, and Bloomington Hills, MI, provides private equity capital to companies throughout all stages of the business cycle. Relativity seeks to invest in the aerospace / defense, industrials, and business and healthcare services sectors. Relativity's key investment initiative is to drive operational excellence in partnership with management. The firm's founders, Leslie L. Armitage and Joyce Johnson-Miller, bring more than three decades of private equity experience, most of which comes through senior positions at The Carlyle Group and Cerberus Capital Management, L.P.

Audit Recommendation	Concur (Yes or No)	Management's Response and Action Plan	Target Date	Individual(s) Responsible
<p><b>1. The AED Director should, upon seeking legal advice, notify Evergreen Maintenance Center, Inc., in writing, of the amount of past due uncollected rent and the correct current lease payment amount.</b></p> <p><i>Defining grounds for termination, Section 16.1.1.3 of the lease agreement states, "Failure by Tenant to make any payment of rent, as and when due, where such failure shall continue for a period of thirty (30) days after written notice thereof by Pinal to Tenant."</i></p>	Yes	Staff is in process of seeking a legal recommendation to determine best course of action in this matter based as it relates to the 1992 amended lease	Dec 31, 2011	AED Director and Pinal County Attorney's Office
<p><b>2. The AED Director should establish a formal billing process, to ensure accurate and timely processing of lease payments. The process should include a requirement to annually compute the lease payment according to the requirements in section 4.3 – 4.3.2 of the lease</b></p>	Yes	This procedure has been implemented but it is going to be formally documented which will illustrate the process and timeline for the lease payment updates.	Dec 31, 2011	AED Director and Public Works Support Services
<p><b>3. The AED Director should develop procedures to:</b></p> <ul style="list-style-type: none"> <li>▪ <b>Verify Pinal Airpark tenants maintain required insurance coverage and retain substantiation on file.</b></li> <li>▪ <b>Require regular inspection of leased property and maintain current property inventory and condition reports.</b></li> <li>▪ <b>Determine when, and how, a tenant is required to repair or replace damaged property.</b></li> <li>▪ <b>Require airport tenants to immediately notify Pinal County when any change of ownership occurs and provide proof of updated insurance coverage under new ownership.</b></li> </ul>	Yes	<p>1&amp;2 Will be coordinated with Lessee and Pinal County Risk Management to insure proper insurance documentation and/or coverage.</p> <p>3- Staff is seeking legal interpretation and review of the 1992 amended lease requirements for repair and/or replacements of damaged property.</p> <p>4- Staff is seeking legal interpretation and review of the 1992 amended lease requirements sections 10.1 and 10.3 of the lease.</p>	Apr 30, 2012	<p>1&amp;2 AED Director, Pinal County Attorney, Risk Management</p> <p>3- AED Director, Pinal County Attorney</p> <p>4-AED Director, Pinal County Attorney</p>

Audit Recommendation	Concur (Yes or No)	Management's Response and Action Plan	Target Date	Individual(s) Responsible
<p>4. <i>The AED Director, in conjunction with County Management and competent legal counsel, should seek approval from the Board of Supervisors to renegotiate the Airpark lease to release the County from any lease provisions that are in violation of the Grant (Quitclaim Deed) restrictions. Appropriate renegotiation of the lease would prevent reversion of the property to the Federal government and allow the County to apply for AIP grants to help finance needed improvements. No new lease should be approved without the expressed written consent of the FAA, per Deed restrictions, and a thorough legal review to verify the legality of all transactions.</i></p>	Yes		<p>Will continue attempts as directed.</p> <p>Awaiting lessee's invitation for continued meetings after Aug 29, 2012 meeting.</p>	AED Staff and Pinal County Attorney
<p>5. <i>Upon successful renegotiation of the lease, approved by the FAA, the AED Director should initiate prudent and active management of the Pinal County Airpark facility that includes developing a business/financial plan and a current Airport Master Plan. The plans should include:</i></p> <ul style="list-style-type: none"> <li>▪ <i>Establishing minimum operating standards;</i></li> <li>▪ <i>Developing an analysis of comparable lease rates at comparable facilities;</i></li> <li>▪ <i>Calculations of replacement value, or cost of maintenance, of assets when determining value for insurance;</i></li> <li>▪ <i>Developing future capital improvement plans for the facility and surrounding area.</i></li> <li>▪ <i>Establishing eligibility for public financing of improvements, such as federal and state grants and Industrial Development bonds;</i></li> </ul>	Yes	Once lease is compliant and approved by the FAA these are items that will be done	<p>Will continue attempts as directed</p> <p>One year after lease is compliant and we have FAA approval</p>	AED Director and Pinal County Attorney's Office

Audit Recommendation	Concur (Yes or No)	Management's Response and Action Plan	Target Date	Individual(s) Responsible
<ul style="list-style-type: none"> <li>▪ <i>Business opportunity costs lost or gained with current tenants</i></li> <li>▪ <i>Establishing lease rates similar to comparable facilities</i></li> </ul>				
<p>6. <i>The Board of Supervisors should consider seeking a legal opinion concerning the appraisal of Airpark property and the possible inclusion of the value of leasehold improvements for tax purposes (IPR's); per State of Arizona Department of Revenue recommendation.</i></p>	TBD by BOS		TBD by BOS	TBD by BOS
<p>7. <i>The AED Director should establish a facility business plan for the San Manuel Airport. A business plan should evaluate and plan for the needs of the operation in the present and in the future. An airport business plan should include:</i></p> <ul style="list-style-type: none"> <li>▪ <i>Schedules for ground, facility and vehicle maintenance.</i></li> <li>▪ <i>Supplies management.</i></li> <li>▪ <i>Review and update of legal and regulatory concerns, including vendor contracts.</i></li> <li>▪ <i>Site safety and security plans.</i></li> <li>▪ <i>Capital improvement program, including possible future products and services.</i></li> </ul>	Yes	<p>Most of these components are in practice or completed.</p> <p>A comprehensive operations manual will be completed.</p>	June 30, 2012	<p>1&amp;2 AED Director, Pinal County Attorney, Risk Management</p> <p>3- AED Director, Pinal County Attorney</p> <p>4-AED Director, Pinal County Attorney</p>
<p>8. <i>The AED Director should establish policies and procedures for proper business revenue management, including:</i></p> <ul style="list-style-type: none"> <li>▪ <i>Establish/update all bank accounts to be consistent with current County policy;</i></li> <li>▪ <i>Formalize procedures for hangar rental and fuel sales billing, collections and deposits.</i></li> </ul>	Yes	<p>Bank accounts have been established with the guidance of the former Pinal County Deputy Treasurer in 2005. Staff currently follows policy 8.10 in handling all collections and deposits.</p> <p>Bank accounts are in the process of being changed to conform to Pinal County Auditor Recommendations</p>	Dec 31, 2011	AED Staff and Pinal County Attorney

Audit Recommendation	Concur (Yes or No)	Management's Response and Action Plan	Target Date	Individual(s) Responsible
		<p>with the aid of the Pinal County Treasurer's Office</p> <p>Procedures are in place and follow all County policies and procedures, but will be documented to illustrate process.</p>		