

ACI-NA 2018-19 BUSINESS TERM SURVEY

2019 BUSINESS OF AIRPORTS CONFERENCE

Airport/Airline Business Working Group
Tatiana Starostina
Dafang Wu

Assisted by Professor Jonathan Williams, UNC

AGENDA

- Background
- Rates and Charges
 - Methodology Overview
 - Expenses and Recovery
 - Rate Details
- Other Contents
 - Capital Review
 - Preferential Gate
 - Miscellaneous

THE ACI-NA BUSINESS TERM SURVEY IS ONE OF THE MOST VALUABLE SOURCES OF AIRPORT RATEMAKING.



- History
 - Since 2003, ACI-NA has conducted several business term surveys regarding airline use agreements.
 - This working group has conducted a major revamp of the survey in 2016-17
- Since 2015, Professor Jonathan Williams has assisted ACI-NA in building a web-based survey that provides a convenient interface for responding and generating outputs.
 - The survey was moved to <https://aci-nasurvey.com/> in early 2019
 - The survey results can be exported to CSV or Excel file, and will be distributed to participating airports in June 2019



ACI-NA RECEIVED 59 RESPONSES IN THE 2018-19 SURVEY, COMPARED TO 60 AND 61 RESPONSES IN THE PRIOR YEAR



- If you have not responded to the survey, please send your airline agreement to us; we will help populate the responses!*

FAA 2017 hub category	Complete or partially complete	Number of airports	% responded	Missing information
Large	22	30	73%	None, need airport approvals
Medium	17	31	55%	Mostly unknown
Small	20	70	29%	Mostly unknown
Total	59			

RATES AND CHARGES OVERVIEW

WE STILL SEE CONFUSION REGARDING THE RATES AND CHARGES METHODOLOGY IN THE 2018-19 SURVEY



- Traditionally, there are only two rate methodologies:
 - Residual: airlines agree to pay any costs of running the airport that are not allocated to other users.
 - Compensatory: the airport operator assumes the major financial risk of running the airport and charges the airlines only for their fair share of costs (instead of whatever is necessary to break even).
- A third category – hybrid – was created in the most recent decade, which leads to confusion.
- The working group has further split hybrid between hybrid residual and hybrid compensatory.

AIRPORT-WIDE RATEMAKING MAY NOT BE THE SAME AS THE COST CENTER RATEMAKING METHODOLOGY.



Residual (airport-wide)

Landing fee is sized to recover all costs, net of all other revenues.

- Terminal rental rate can be any methodology

Residual (dual cost center)

Airfield: residual, or net of some landside profit/loss

Terminal: residual, net of all other landside profit/loss

Hybrid Residual

Airfield: any method

Terminal: any method

Landside: shared, with residual protection

Hybrid Compensatory

Airfield: any method

Terminal: any method

Landside: shared, without residual protection

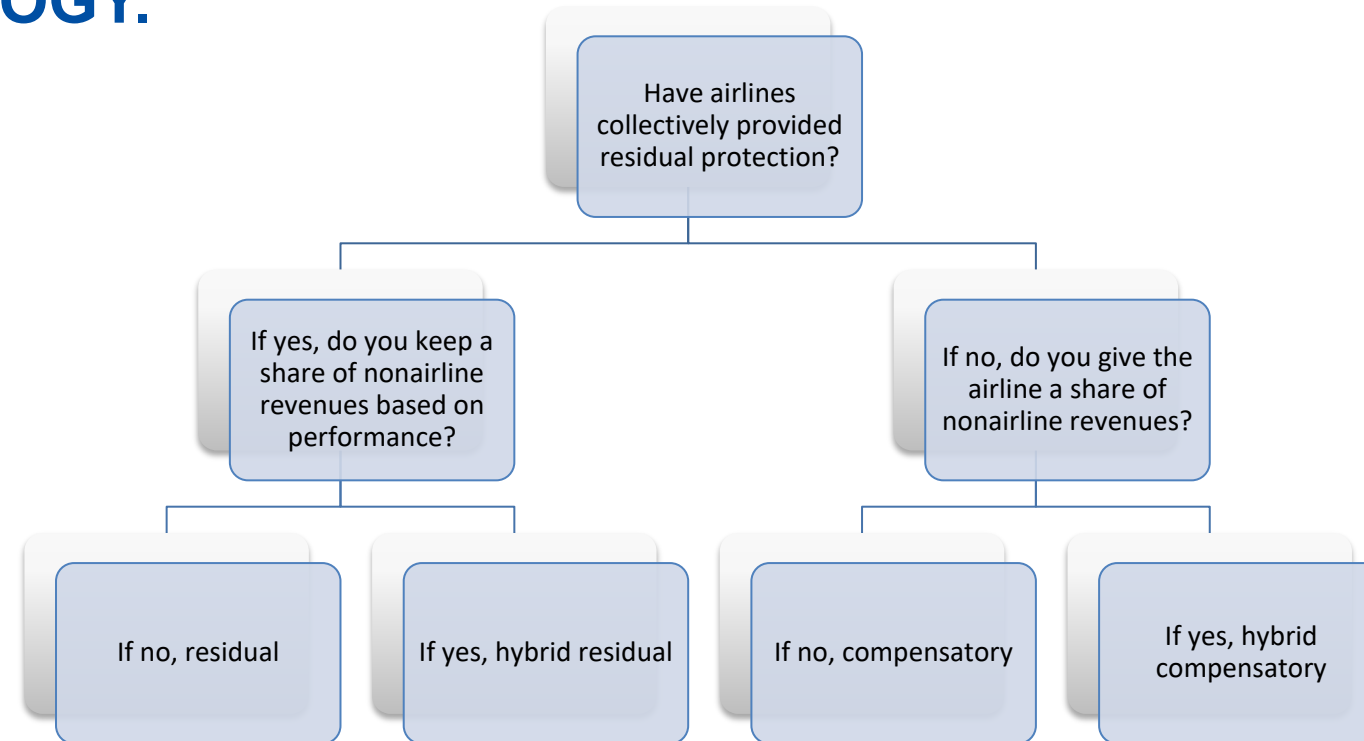
Compensatory

Airfield: any method

Terminal: compensatory

Landside: kept by airport

RESIDUAL PROTECTION AND REVENUE SHARING ARE TWO KEY ISSUES TO DETERMINE RATE METHODOLOGY.

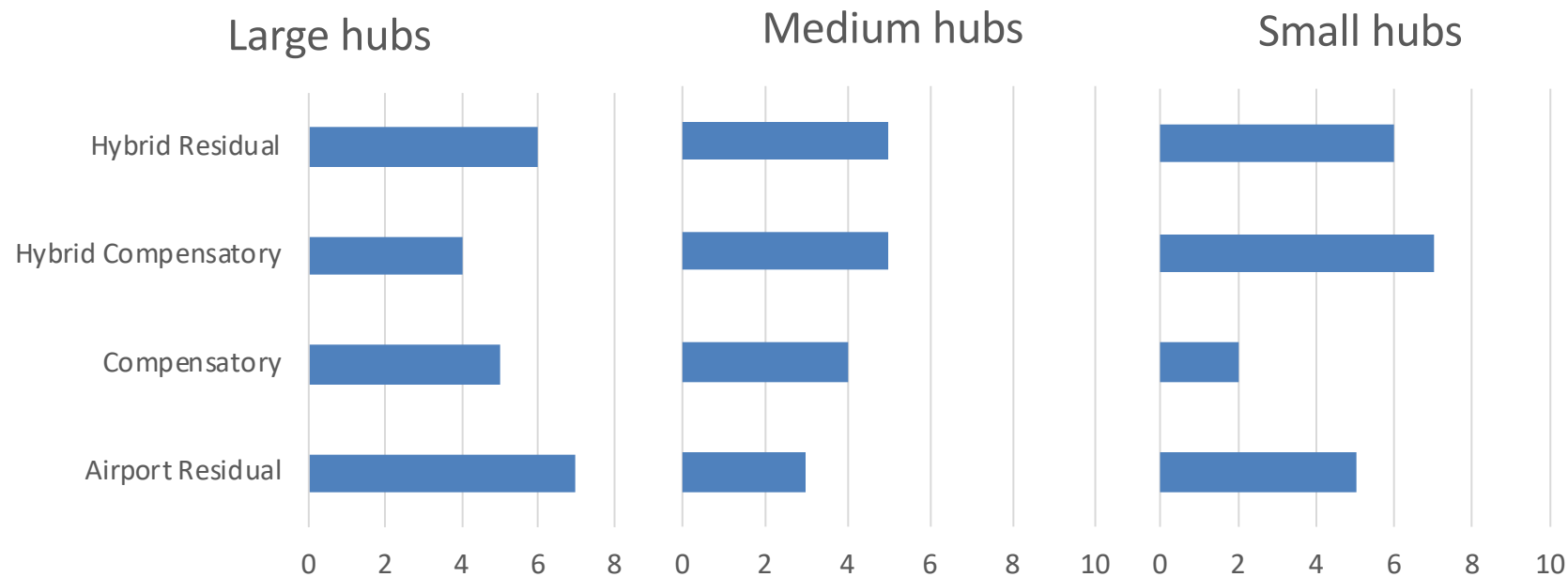


- Materiality
 - A residual airport can have a small cost center not guaranteed by airlines.
 - A residual airport can keep a small portion of nonairline revenues (e.g., profit/loss from cargo cost center) and still be called residual instead of hybrid.

RESIDUAL/HYBRID RESIDUAL SLIGHTLY OUTNUMBERS COMPENSATORY AND HYBRID COMPENSATORY IN THE 2018-19 SURVEY



- 4 large hubs and 2 medium hubs reported rate-setting under unilateral resolutions.
- 13 large-hub airports reported residual or hybrid residual.
- 8 medium-hub airports reported residual/hybrid residual.



LONG-TERM AGREEMENT IS STILL POPULAR AMONG LARGE HUBS, LIKELY DUE TO CAPITAL PROGRAM.



Less than 5

- Rate by resolution airports (BOS and PHX)
- Rate agreement (MCO)
- Auto-renew (HNL)

5-7 years

- BWI
- DEN (WN)
- PHL
- SAN
- SEA

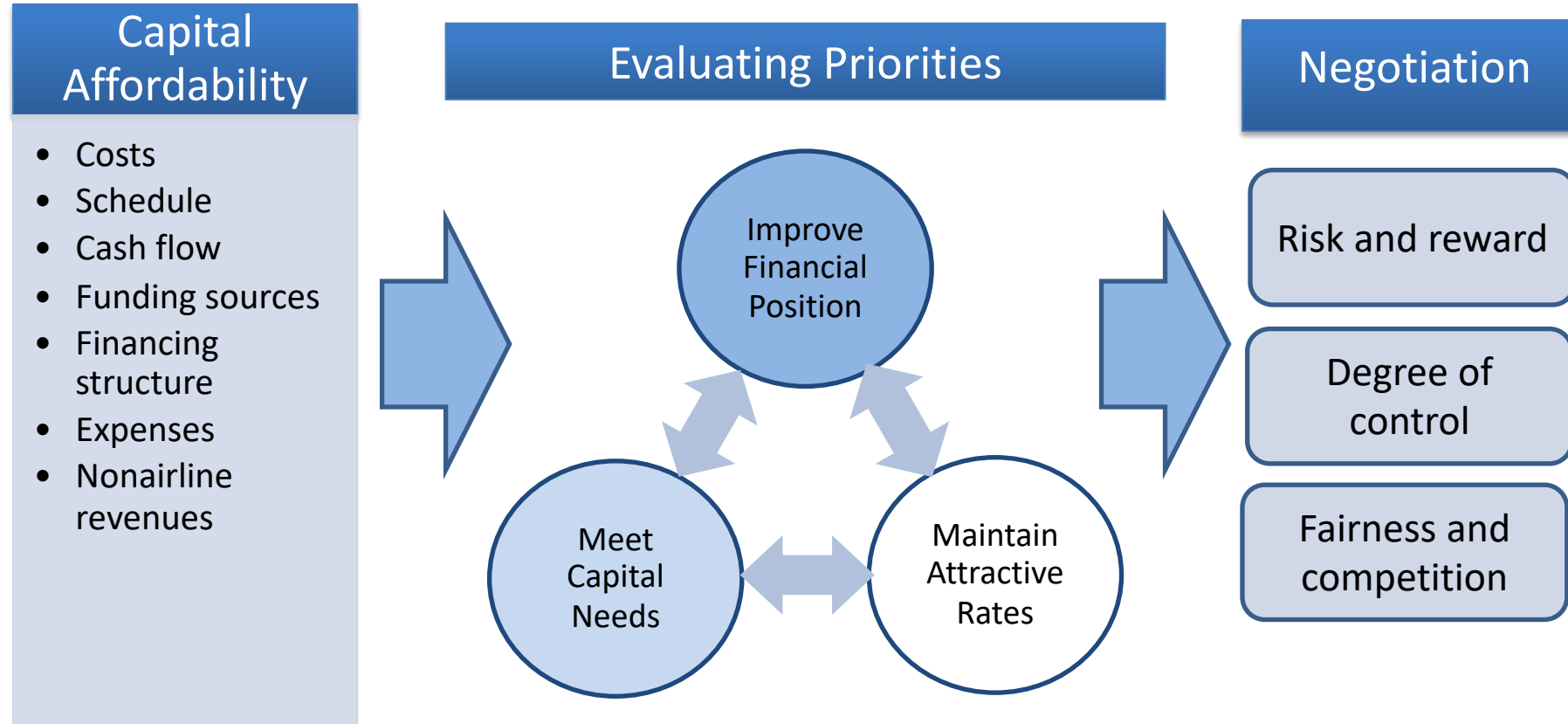
10 years

- CLT, DCA, DFW, IAD, LAS, LAX (rate agreement), PDX, SFO, SLC, TPA (extended)

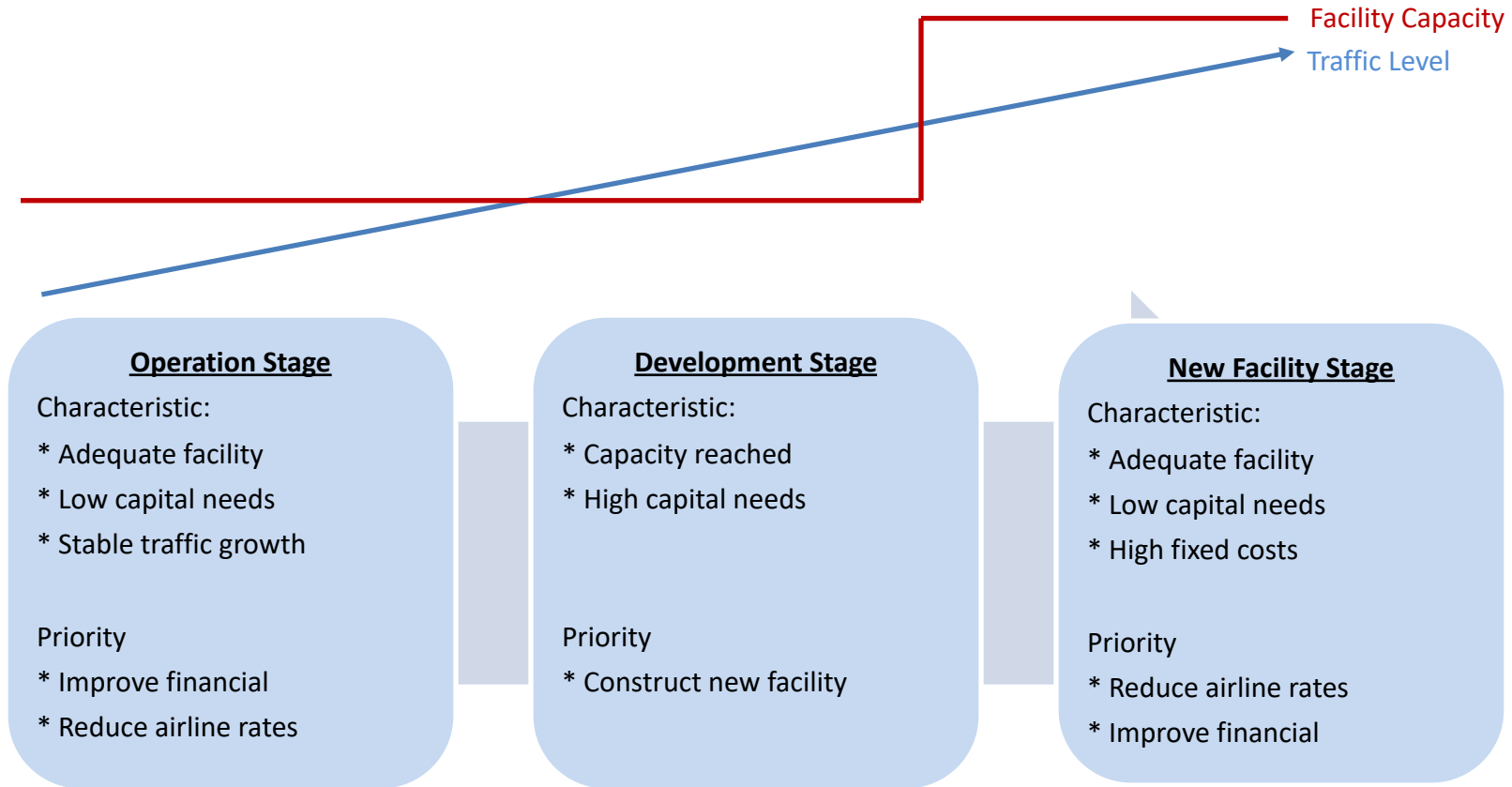
> 10 years

- ATL, DTW, FLL (extended), IAH, MDW, MIA, MSP, ORD (new agreement)

THE RATEMAKING METHODOLOGY IS DETERMINED BY CAPITAL NEEDS, PRIORITIES, AND NEGOTIATION POWER



EACH AIRPORT TRIES TO PRIORITIZE OBJECTIVES THROUGH DIFFERENT FACILITY DEVELOPMENT STAGE



All the main conflicts between airports and airlines are about the capital program:

- Airports want to build facility for future needs
- Having a high cost of capital, airlines want to defer investment when possible

EXPENSES AND RECOVERY

ADMINISTRATIVE EXPENSES ARE TYPICALLY ALLOCATED BASED ON DIRECT EXPENSES.

- A majority of the respondents (54 out of 59) reported that they include some kind of operating expense allocation procedure in the airline agreement.
 - This ranges from a simple statement such as “Indirect expenses shall be allocated according to the distribution of direct expenses” to very detailed exhibits showing the allocation ratios of each function.
 - Note: A different number of airports responded to each question.
- 33 out of 56 respondents reported that they allocate administrative expenses according to direct expenses, and another 15 responded that they allocate administrative expenses based on management estimates.
 - 5 airports included operating revenues as one factor to allocate administrative expenses.

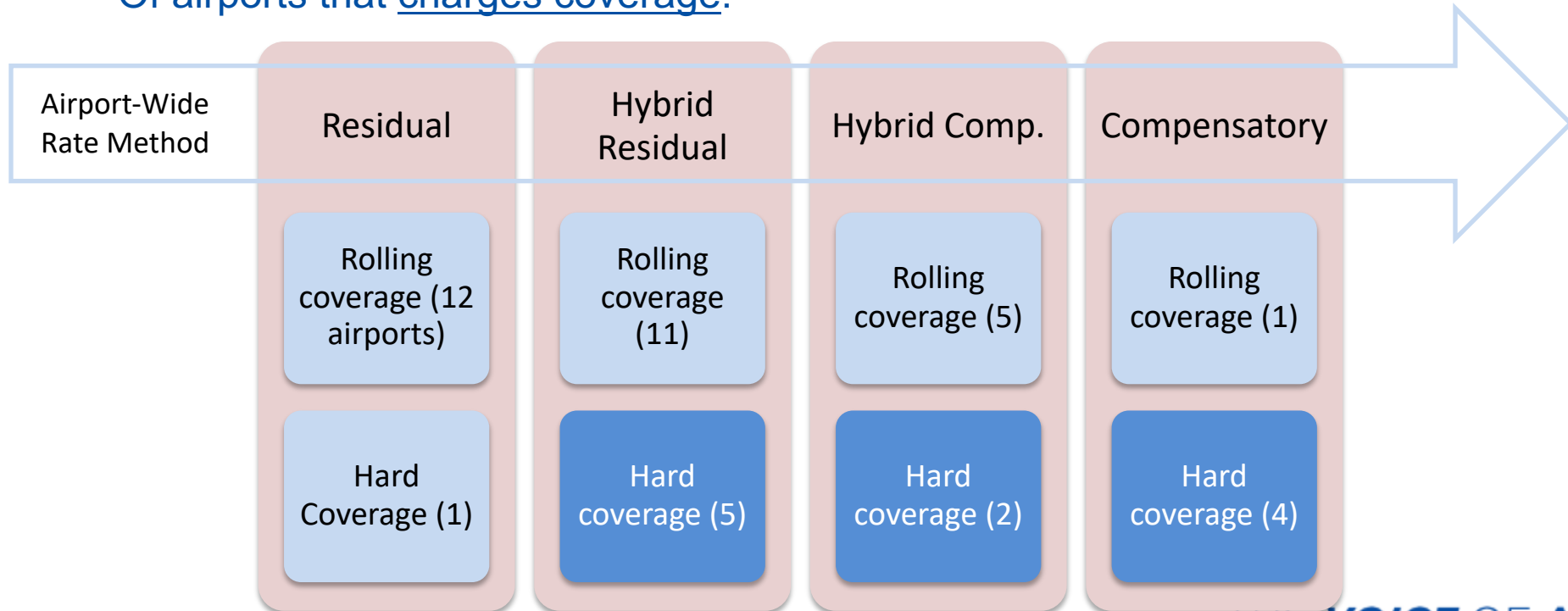
DEBT SERVICE OR INTERNAL CASH SPENT ON CAPITAL PROJECTS COULD BE INCLUDED IN AIRLINE RATE BASE.



- About 87% of respondents reported that they allocate debt service to airline cost centers to recover debt service instead of using depreciation/amortization for bond-funded assets.
- About half of respondents responded that they depreciate airport-funded capital costs
 - This question will be clarified in future surveys – it is intended for airport internal cash funded capital costs
- For interest rates used to recover costs:
 - 29% of respondents are using average borrowing rates
 - 26% are using fixed rate
 - 17% are using projected borrowing rates
 - Other airports are primarily using certain bond index rates

DEBT SERVICE COVERAGE REQUIREMENT IS TYPICALLY FUNDED BY ROLLING COVERAGE.

- The bond document typically requires two tests: a flow test to ensure adequate cash flow, and a coverage test to preserve a safety margin.
- Rolling coverage funds the safety margin only once.
- Of airports that charges coverage:



INVESTING DISCRETIONARY CASH FLOW AND RECOVERING THROUGH AMORTIZATION IS A KEY ACTION TO IMPROVE FINANCIALS



- Amortization of cash investment creates true cash flow that rating agencies value
 - Through a cash flow coverage calculation, rating agencies exclude all non-cash-flow items, such as rolling coverage, or even landing fee credit from prior year
 - Amortization, on the other hand, is a recurring revenue stream recovered from airline rates. It serves as a cushion for debt service coverage

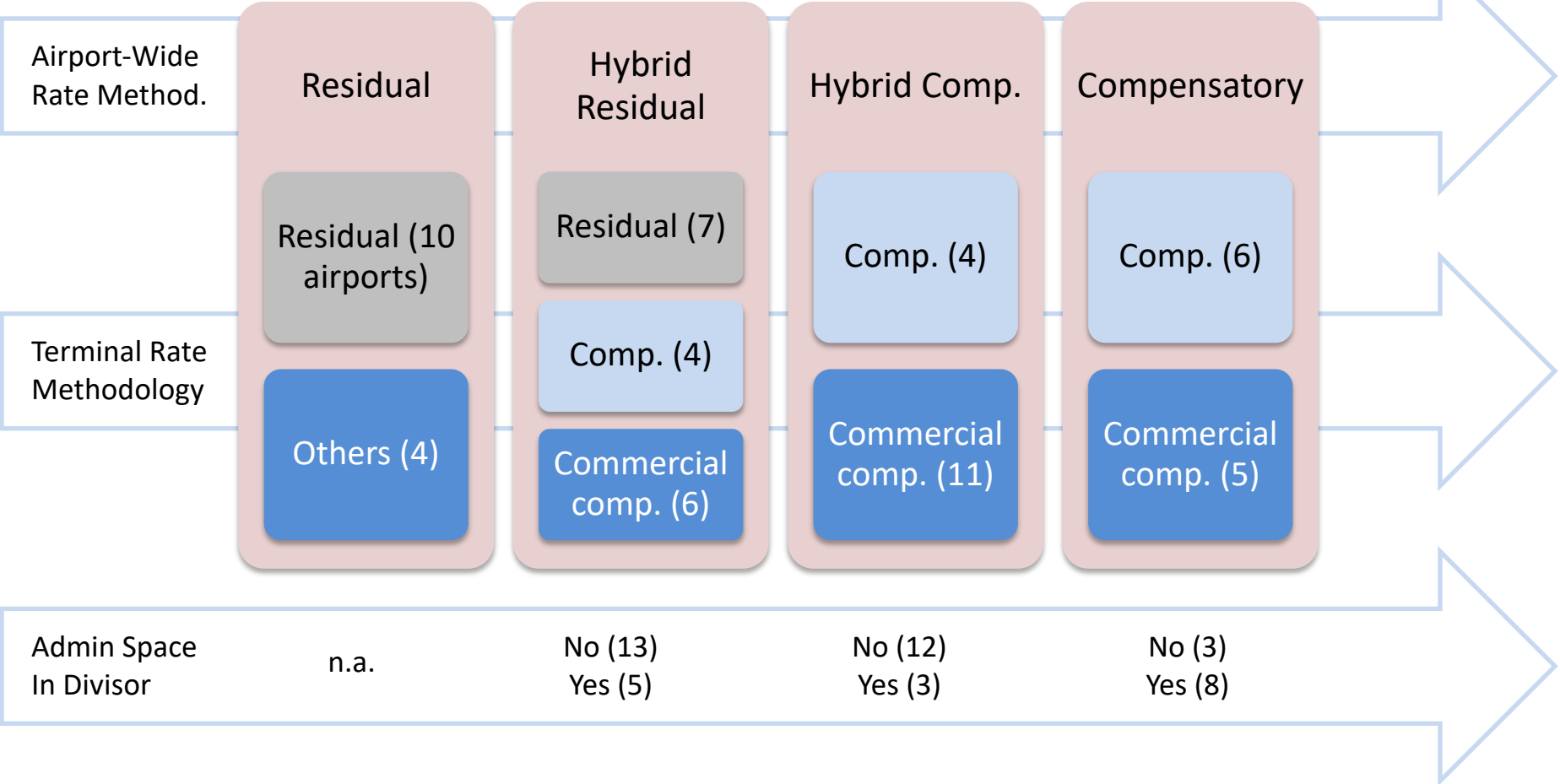
	Pure Residual Ratemaking			
	Year 1		Year 10	
	Airport A	Airport B	Airport A	Airport B
O&M Expenses	\$ 100	\$ 100	\$ 100	\$ 100
Debt Service	20	20	25	20
Discretionary Cash	5	5	5	5
Amortization	-	-	-	5
Total Revenues	\$ 125	\$ 125	\$ 130	\$ 130
Coverage	1.25	1.25	1.20	1.50

RATE DETAILS

RESIDUAL LANDING FEE METHODOLOGY IS THE NORM.

- Although an airport cannot impose airport-wide residual ratemaking on airlines, the landing fee rate can be calculated using an approach similar to residual:
 - Aggregate of airfield-related direct and indirect operating expenses, debt service, and fund deposit
 - Net of general aviation-related fuel flowage fee and other revenues
 - Divided by the sum of signatory and non-signatory airline landed weight
- Comparatively, a compensatory landing fee is calculated by dividing the net requirement by the total landed weight (commercial airlines plus general aviation and other activities).
- ***Revising landing fee methodology may have tax implications – discussion with tax counsel is a must!***

MORE AIRPORTS ARE USING A COMPENSATORY OR COMMERCIAL COMPENSATORY FOR TERMINAL RATEMAKING.



AIRPORTS TEND TO CUSTOMIZE REVENUE SHARING TO FIT THEIR SPECIFIC NEEDS



- Of hybrid residual and hybrid compensatory airports, 24 airports reported revenue sharing, with many variations.
 - 12 airports share a fixed % of net remaining revenues
 - 5 airports share a variable % of net remaining revenues
 - Other airports may tie this amount to enplaned passengers or other performance metrics
- As to allocation of revenue sharing:
 - 10 airports allocate revenue sharing partly based on enplaned passengers
 - 4 airports allocate partly based on landed weight
 - 6 airports allocate partly based on rented space

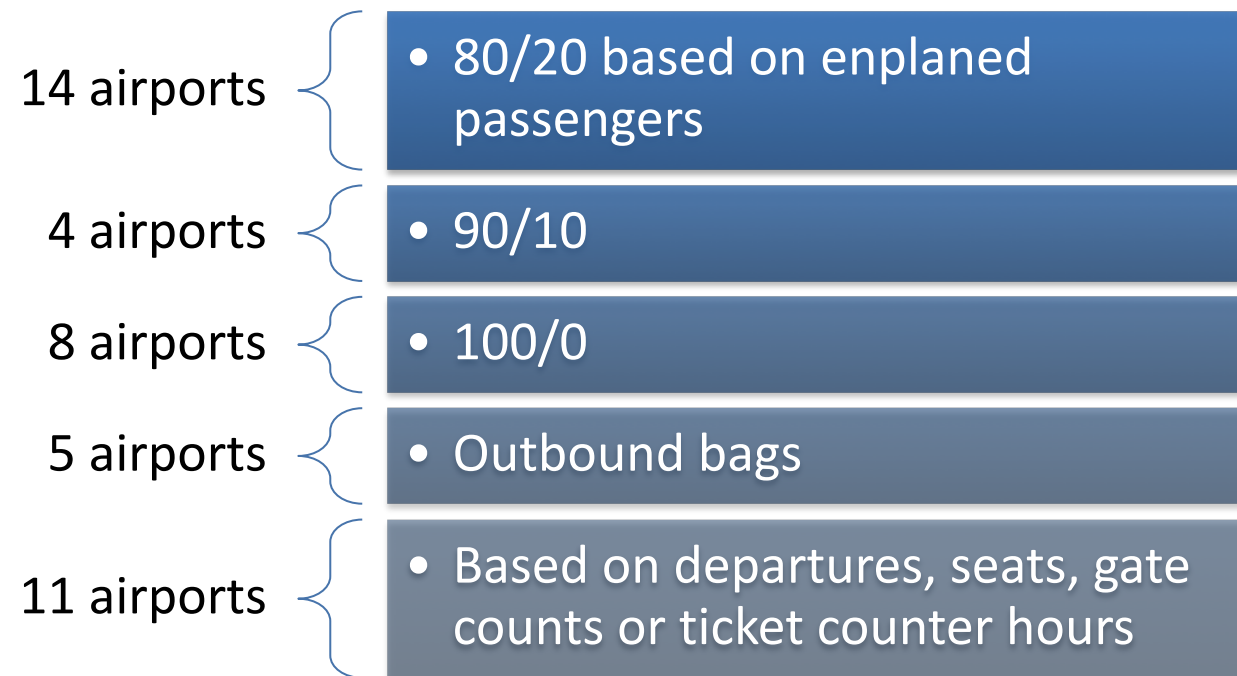
MORE AIRPORTS ARE USING 90/10 OR 100/0 FORMULA TO ALLOCATE BAGGAGE CLAIM EXPENSES



- Historically, 80/20 has been the standard formula allocating baggage claim expenses.
 - 80% based on enplaned or deplaned passengers
 - 20% based on the number of users
- In this survey, 15 airports reported 100/0 for passenger or bag count (no fixed fee portion), 6 reported 90/10, and 21 reported 80/20.
 - Some airports exclude low-volume carriers from the allocation of the fixed fee portion.
 - 6 out of the 15 airports above allocate baggage claim costs based on bag count.
 - Other methods may be used in baggage claim allocation, such as seats or turns

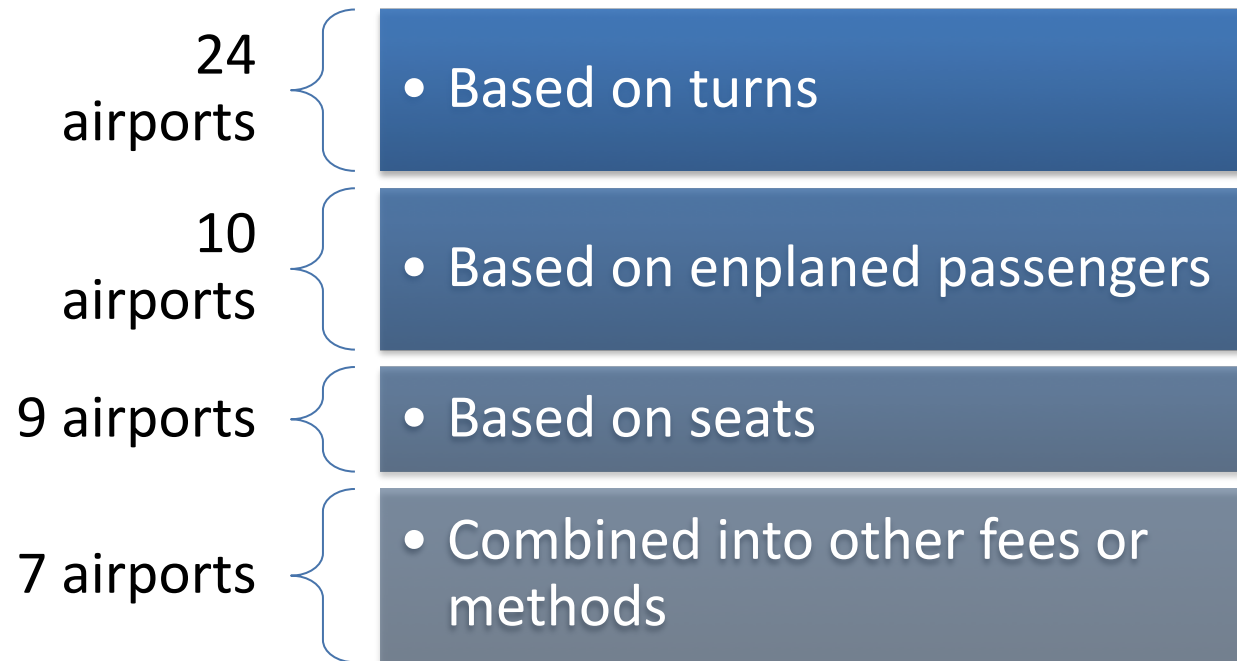
BAGGAGE MAKEUP SPACE IS NOT NECESSARILY AVAILABLE ON A COMMON USE BASIS.

- Many airports have common use baggage makeup of some kind, but more than 25% of airports reported that they do not offer baggage makeup on a common use basis.
- Among 41 airports with common use baggage makeup space:



HOLDROOM COST ALLOCATIONS TEND TO INCLUDE TURNS AS A FACTOR.

- Some airports reported that they do not offer common use holdrooms.
- Among 50 airports with common use holdroom space:



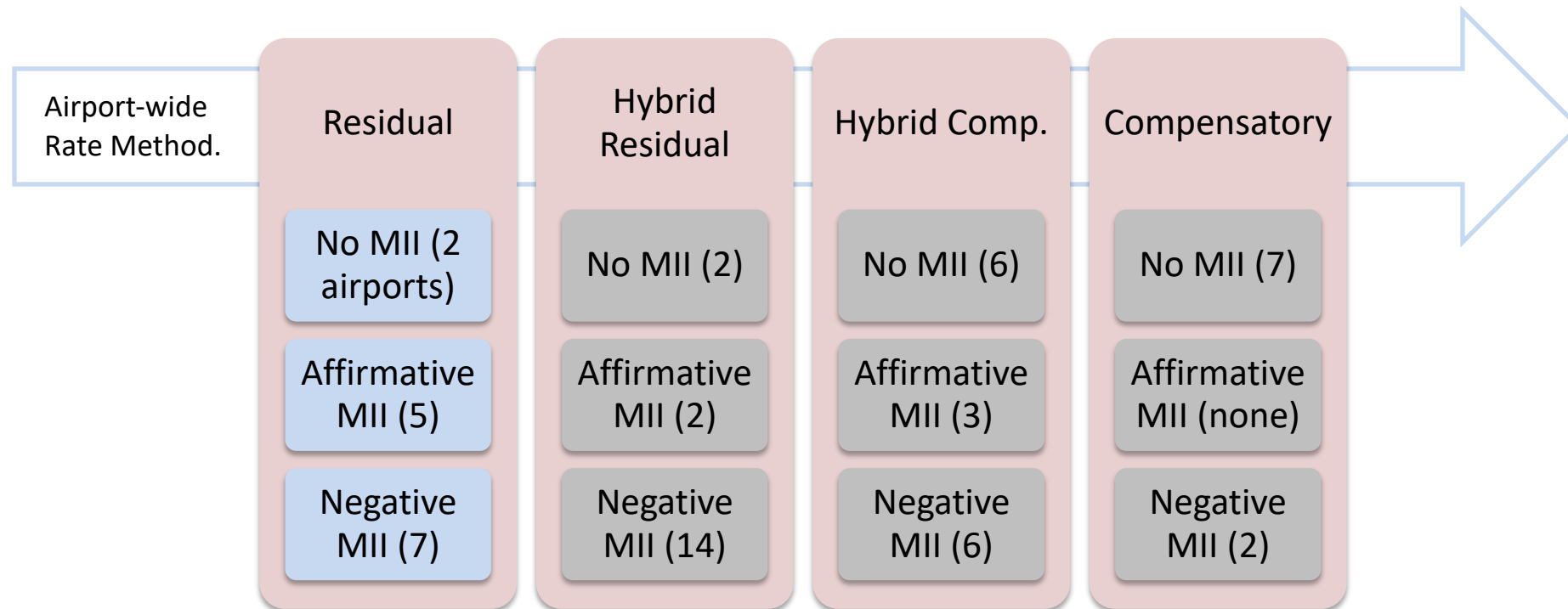
A GOOD AIRLINE RATEMAKING METHODOLOGY ENCOURAGES SOUND DECISIONS

- In many cases, many options are acceptable to balance priorities
 - Residual vs. compensatory for risk/reward
 - Preferential vs. common use to balance utilization
 - Using flight vs. using seats to allocate costs
 - Allocating revenue sharing to incentivize service
- In some cases, there are clear preference
 - Including amortization of cash investment to encourage prudent financial planning
 - Excluding administration space from rentable space to eliminate odd incentives
 - Properly allocating expenses to airline cost centers, such as roadway costs

OTHER CONTENTS

THE CAPITAL REVIEW PROCESS IS CLOSELY TIED TO RATEMAKING METHODOLOGIES.

- Affirmative MII: an airport cannot proceed unless it receives enough airline approvals.
- Negative MII: an airport can proceed unless it receives a certain amount of airline disapprovals.



THE CAPITAL REVIEW PROCESS IS ALSO INFLUENCED BY KNOWN CAPITAL NEEDS.

- Other issues to consider in the capital review process:
 - Exempted projects
 - Pre-approved CIP
 - High MII threshold based on airline-paid project costs
 - Annual allowance or deposits to maintenance reserve
 - Small capital outlay or equipment purchase
 - Separate MIIs for airfield vs. terminal (how about one for int'l arriving building/FIS?)
- One-third of airports reported that they cannot proceed with a project if airlines rejected it twice under the negative MII.
 - For the remaining two-thirds, one phrase is recommended to add: “Airport can proceed with the proposed capital projects after a delay of <<>> months, **and include the related operating expenses and capital costs in the calculation of airline rates and charges.**”

THERE IS A WIDE RANGE OF QUALIFICATION CRITERIA FOR PREFERENTIAL GATES.

- Of 53 airports responding, 30 have not set a threshold
- Of the remaining 23 airports:
 - 13 airports selected 4-7 daily turns as the criteria
 - 5 airports selected seats as the criteria, including fixed seats per gate, or allocating based on share of schedule seat
 - Other airports use airport average or assign gate at the airport's discretion
- Some issues to consider:
 - Should the threshold be dynamically tied to seats or turns?
 - Should there be an initial threshold and a maintenance threshold, similar to equity investment?
 - Should the common use fee for an airline be capped if they qualify but can't get a gate?

PREFERENTIAL GATE ALLOCATION BECOMES A HOT TOPIC IN RECENT AIRLINE NEGOTIATIONS



- Key aspects of negotiation:
 - Frequency: annually vs. as-needed
 - Timing: how many months before the fiscal year?
 - Number of common use gates preserved before allocating preferential
 - Limitation
 - Incremental annual changes
 - Basis: seats, passengers or flights?
 - Evaluation period: one month or one year?
 - Data source: airline report or 3rd party sources?
 - Reasonability: how to prevent an carrier claiming unnecessary gates?
 - Financial affordability: should common use fee be capped at preferential gate costs?

NEXT STEPS

ACI-NA PLANS TO CONDUCT A WEBINAR LATER THIS YEAR TO DISCUSS THIS SURVEY AND RECENTLY COMPLETED AIRLINE NEGOTIATIONS



- How can participants benefit from this survey?
 - Survey result summary, such as this presentation
 - Follow-up to confirm and revise responses
 - Experience from airports recently completing negotiations
 - Research on key topics, such as gate allocation
- This can be a good learning opportunity for your staff. Please email dwu@dwuconsulting.com if:
 - You are not certain whether your airport has responded to the survey, or
 - Your staff wants to learn more about the survey questions.
- Please feel free to send suggestions and observations!

Thanks to everyone who has assisted with this survey!

THE
VOICE
OF
AIRPORTS®



SUSTAINABILITY INTEGRATION & ADVISORY COUNCIL

Sharon Sarmiento, Ph.D.
Principal
Unison Consulting, Inc.
June 10, 2019



ACI-NA's EONS Framework

- A holistic approach to airport management - promote EONS
- Sustainability transcends environmental stewardship.



In 2017, ACI-NA Board formed a new...

Sustainability Integration & Advisory Council

to lead and facilitate

an integrated approach to industry efforts

to optimize economic, environmental, and social capital

Sustainability should be a cross-disciplinary,
cross-committee endeavor

COUNCIL MEMBERSHIP

Position	Name	Representing	Home Committee
Chair	Kurt Gering	SAN	Human Resources
Vice-Chair	Melissa Solberg	TPA	Environmental Affairs
ACI-NA Board Liaison	Matt Cornelius	ACI-NA	
ACI-NA Committee Secretary	Melinda Pagliarello	ACI-NA	
Liaison	Brendan Reed	SAN	Environmental Affairs
Liaison	Sharon Sarmiento	Unison Consulting	Finance
Liaison	Kirstan Jewel	YEG	Human Resources
Liaison	Jai Ferrell	ATL	Marketing & Communications
Liaison	Eddie Clayson	SLC	Operations & Technical Affairs
	Danielle Buehler	PHL	Environmental Affairs
	Brian Holtman	Vino Volo	Commercial MGT
	Steve Nakana	PDX	Business Diversity
	Chris Kaminski	DTW	Risk Management
	Carly Shannon	C&S	Environmental Affairs
	Dafang Wu	DWU Consulting	Finance
	Joan Zatopek	OAK	Operations & Technical Affairs

FIRST-YEAR PRIORITIES

1. **Populate the Council's roster** with diverse representatives from ACI-NA's established Committees.
2. **Spread awareness** across the Committees of the Council's purpose and role.
3. **Enhance ACI-NA conference programming** with sustainability-related topics.
4. **Initially focus on "Sustainable Aviation Fuel"** as a topic requiring an integrated approach throughout the ACI-NA Committee network.

HOW CAN YOU BECOME INVOLVED?



Volunteer to represent
your Committee on
the Council



Engage your
Committee on topic
ideas for conferences



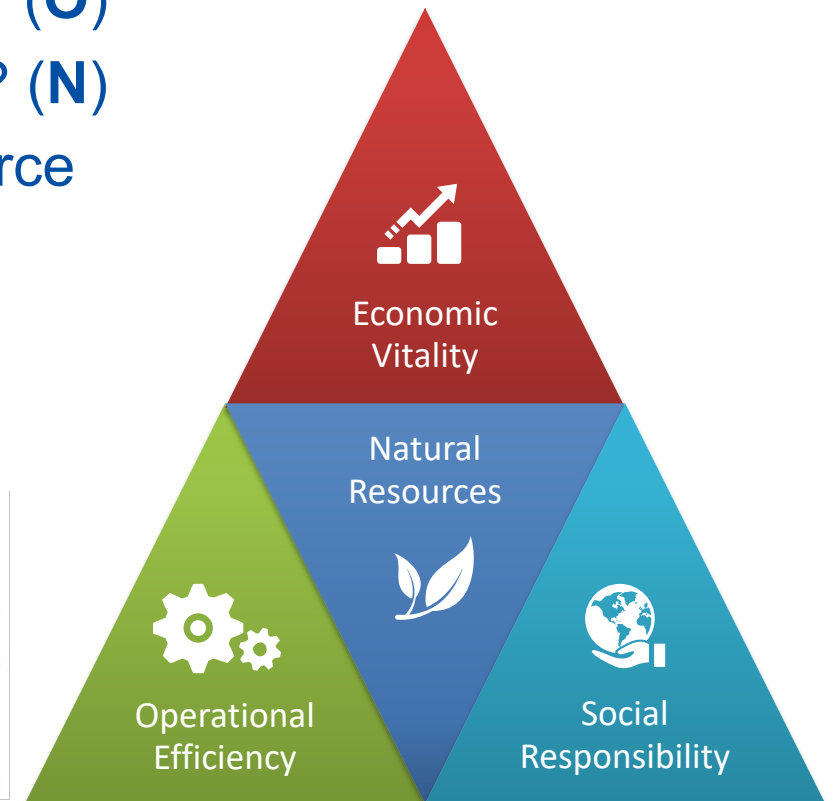
Share the Council's
work products with
your colleagues



SUSTAINABLE AVIATION FUEL (SAF)

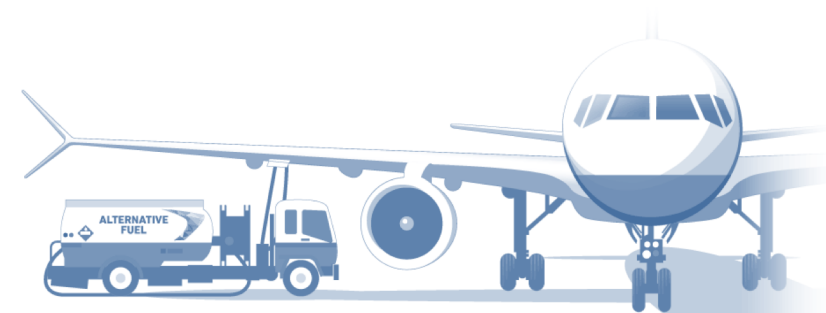
A Triple-Bottom Line Example

- Can SAF boost local economic development? (**E**)
- Do airports need new infrastructure for SAF? (**O**)
- What are the emission reductions from SAF? (**N**)
- Will SAF require new community and workforce development efforts? (**S**)



WHAT IS THE ROLE FOR FINANCE AND FINANCIAL SUSTAINABILITY

- As a contributor
 - As a parallel consideration
 - As a driver
-
- Generate revenues
 - Identify funding sources
 - Save costs



SUSTAINABILITY MEASURES THAT IMPACT FINANCIAL SUSTAINABILITY

- Airport waste management and recycling practices that reduce O&M costs
- Energy conservation practices that reduce O&M costs
- Building sustainability concepts that enhance airport capacity and reduce the need for capital outlays over the long run
- Airports' adaptation to climate change to protect airport infrastructure investments

EXAMPLES OF SUSTAINABILITY EFFORTS THAT ALSO PROMOTE FINANCIAL SUSTAINABILITY

- San Diego International Airport Green Concessions Program
- San Diego International Airport ParkSmart Gold Certification
- Fort Lauderdale International Airport U.S. Green Building Council ParkSmart Certification
- Toronto Pearson International Airport Green Commuter Program
- San Francisco International Airport Electric Bus Fleet
- Gerald R. Ford International Airport Recycling Program
- Chicago Department of Aviation Green Concessions Policy
- San Francisco International Airport Sustainable Food Guidelines
- Tampa International Airport Sustainability Design and Construction
- Jackson Hole Airport Sustainable Water Program
- Many more!

For more information about the Sustainability
Council and resources, please contact:
Melinda Pagliarello
MPagliarello@airportscouncil.org

AIRPORT FINANCIAL SUSTAINABILITY

Tatiana Starostina
Assistant Director of Aviation – Business & Strategy
Oakland International Airport
June 10, 2019

PRESENTATION TODAY

- The Role of Finance in Sustainability Efforts
- Current Trends in Airport Finance
- Key Levers of Airport Financial Sustainability
- Alternative Funding for Sustainability Projects

ROLE OF FINANCE IN AIRPORT SUSTAINABILITY

- Finance view is essential for applying checks and balances in the organization
- Financial stability is a prerequisite of sustainable development
- Finance's role must go beyond transactional support:
 - Long-range planning
 - Rate strategies
 - Capital allocation
 - Benchmarking
 - Performance targets
 - Data analytics

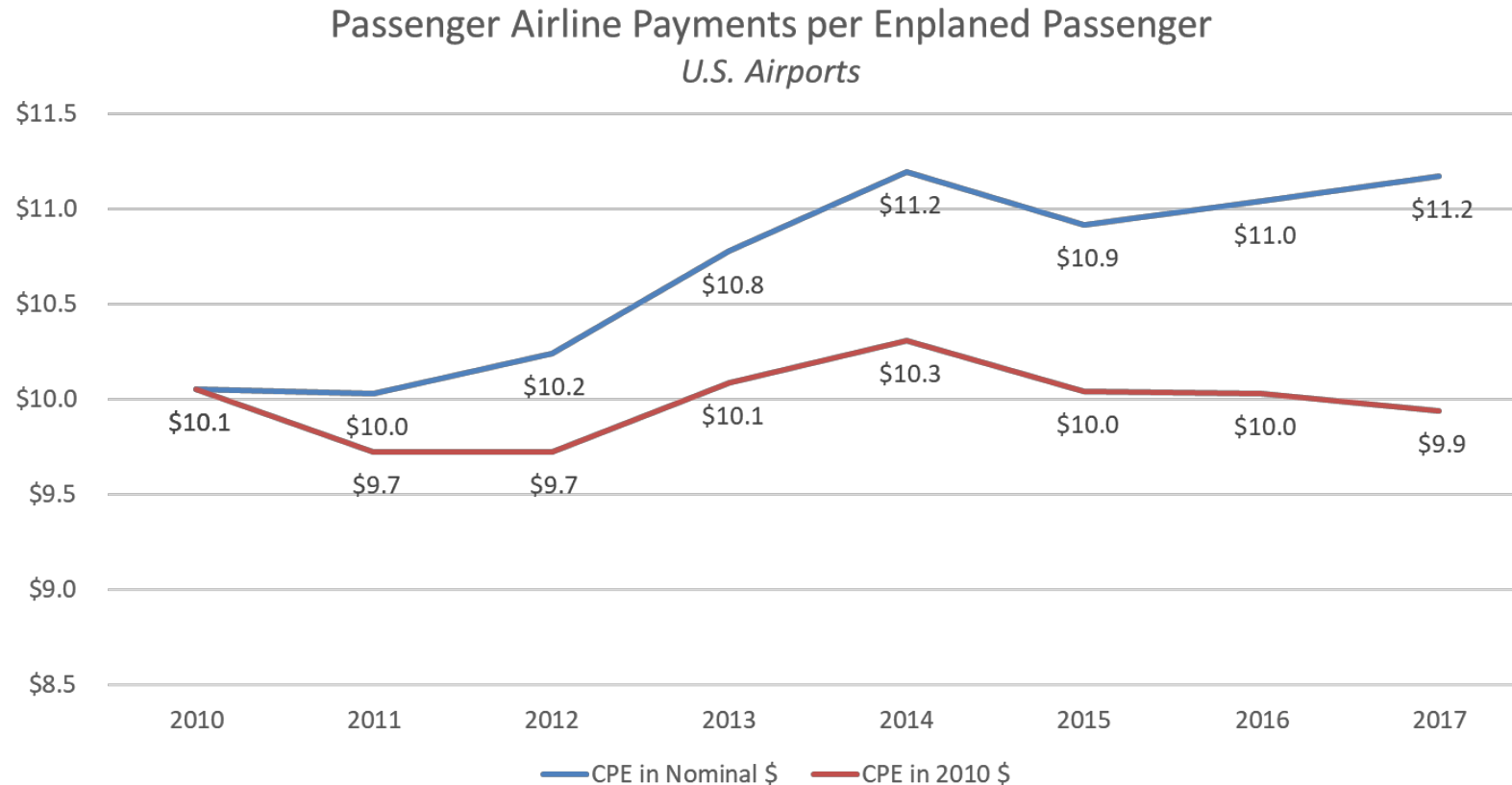


CURRENT TRENDS IN AIRPORT FINANCE

- Average CPE in constant dollars has not increased in recent years.
- Non-aeronautical revenues per enplaned passenger barely exceed inflation.
- O&M expenses increase 2-3% above inflation.
- High capital needs to accommodate incremental traffic may drive costs.
- Debt remains the main funding source, increasing financial risk.

Source: Dafang Wu. State of the U.S. Airport Industry, From a Financial Perspective. 2018
ACI-NA National Conference. Sep. 30 – Oct. 2, 2018. Nashville, TN

AVERAGE CPE GROWTH HAS NOT EXCEEDED INFLATION



Source: Respective fiscal year data from FAA Form 5100-127, excluding 2009 due to data issues.

Source: Dafang Wu. State of the U.S. Airport Industry, From a Financial Perspective. 2018
ACI-NA National Conference. Sep. 30 – Oct. 2, 2018. Nashville, TN

THE **VOICE** OF AIRPORTS®

AIRPORT FINANCIAL SUSTAINABILITY TOOLS

- Airline Rates and Charges:
 - Properly recovering expenses is critical
 - Cost center structure
 - Rentable space definition
 - Allocation of indirect costs
 - Cash generating and cash management strategies
 - Adopting commercial compensatory rate methodology
 - Revenues excluded from sharing or rate credit
 - Reserves
 - Amortization
 - Funded coverage
 - Balancing risks and benefits
 - Which risks are important to transfer and at what price



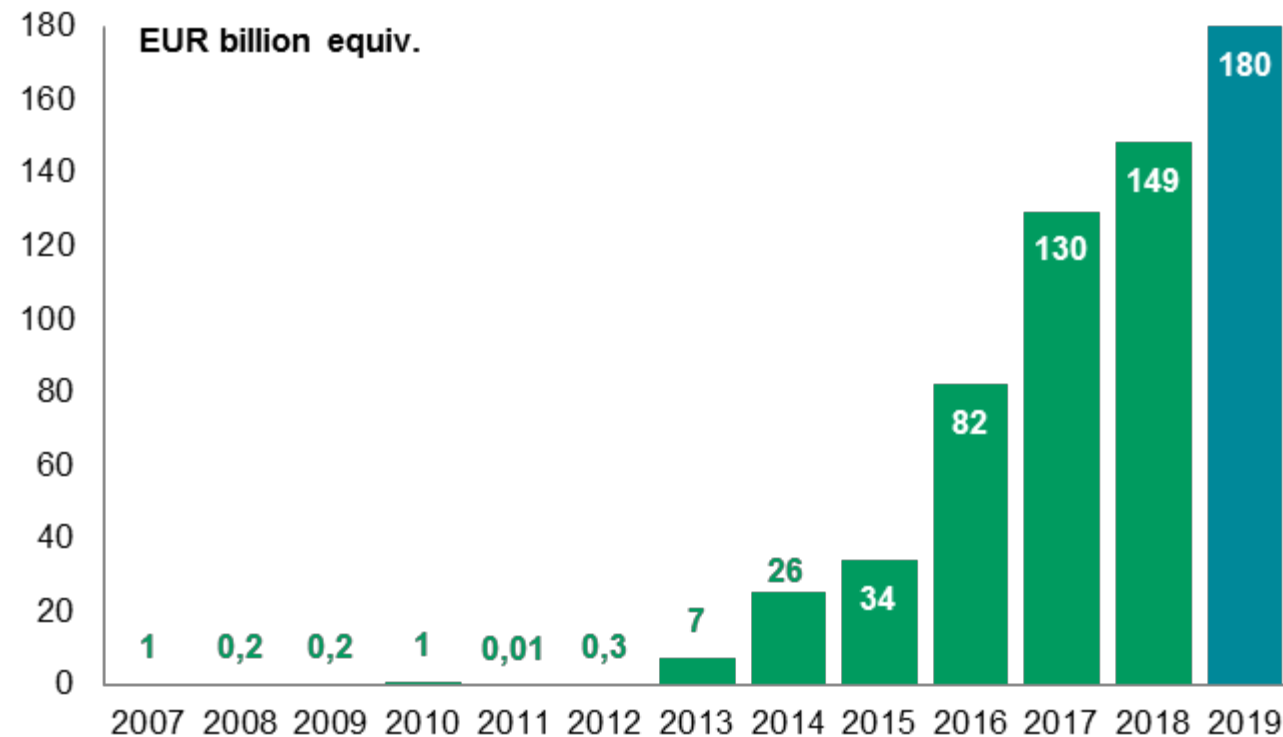
AIRPORT FINANCIAL SUSTAINABILITY TOOLS

- Protecting and growing nonairline revenues
 - Parking yield management
 - Airport access monetization strategies
 - Real estate development
- Operating cost management and controls
- Capital investment prioritization
- Alternative funding sources for sustainability projects

GREEN BONDS

- Green bonds were created to fund projects that have positive environmental and/or climate benefits.
- Started in 2008 by World Bank, as a way to connect financing from investors to climate projects.
- Created a model for project selection, second party opinion and impact reporting
- “Green Bond Principles” (GBP) are voluntary best practice guidelines with four core components:
 1. Use of proceeds
 2. Process for project evaluation and selection
 3. Management of proceeds
 4. Reporting
- Other concept evolving: Social Bonds, Sustainability Bonds, Sustainable Development Bonds

GREEN BOND MARKET ISSUANCES



Source: Dealogic, Crédit Agricole CIB Sustainable Banking (as of December 31st, 2018)
Forecast: Crédit Agricole CIB Research – Green Bond Analyst Erwan Créhalet

WHY GO GREEN?

S&P Global Ratings Green Evaluations:

- Diversify your investor base
- Potential to enjoy long term pricing advantages
- Track green performance
- Send a strong, pro-active message to stakeholders
- Appeal to millennials as employees and customers

GRANTS FOR ENVIRONMENTAL PROJECTS

- FAA - VALE
- EPA Clean Diesel and Diesel Emission Reduction (DERA)
- VW Clean Air Act Settlement:
 - VW Air Quality Mitigation Trust: \$2.9 billion distributed to 50 states , District of Columbia, Puerto Rico, and tribal lands
 - ZEV Investment Plan: \$2 billion. Goal: promote ZEV by establishing charging network
- State (e.g. Carl Moyer)
- Regional (e.g. Southeast Diesel Collaborative)

- Project Types:
 - Charging station for vehicles and eGSE
 - Alternatively fueled vehicles
 - Energy efficiency upgrades
 - Gate electrification
 - Central Utility Plant upgrades

GOOD TRAVELER PROGRAM

- Travelers, businesses and event organizers can buy carbon offsets based on the length of their trip.
- Purchases fund carbon reduction projects.
- The Good Traveler was founded in 2015 by San Diego International Airport and is managed by the nonprofit Rocky Mountain Institute.
- Current participants: ATL, AUS, DFW, Port Authority of New York and New Jersey, SEA, SFO
- thegoodtraveler.org

