SAN DIEGO COUNTY
REGIONAL AIRPORT AUTHORITY

STAFF REPORT

Item No. 6

Meeting Date: **MARCH 3, 2011**

Subject:

Revise the Authority's International Air Service Incentive Program to Refine the Program's Application and Increase Its Utility

Recommendation:

Adopt Resolution No. 2011-0034, revising the Authority's International Air Service Incentive Program.

Background/Justification:

Current International Air Service Program Deficiencies

At its October 4, 2007 meeting, the Board authorized the establishment of the Authority's International Air Service Incentive Program ("IASIP") to encourage airlines to develop nonstop and/or triangular air service between San Diego and airports in Europe, Central America, South America, Asia, Oceania (i.e., Australia, New Zealand, and principal islands of the central and south pacific), and Africa. To qualify for the program, an airline would have to institute new air service to a destination airport not currently served by such service with a minimum of two scheduled roundtrips per week on a year round basis. (Note: destinations in Canada, Mexico, and the Caribbean are covered by the Authority's Domestic Air Service Incentive Program and are not eligible for the IASIP.)

Under the IASIP, the Authority may provide three financial incentives to an airline instituting a qualifying service: (1) Reduced landing fees (100% for the first twelve months of service and 50% for the second twelve months); (2) Reduced terminal rent (100% for the first 12 months of service and 50% for the second 12 months); and (3) Marketing assistance (up to $500,000 for the first 12 months and up to $250,000 for the second 12 months).

The IASIP was instrumental in British Airways' recent decision to institute nonstop air service between London Heathrow Airport and San Diego in June 2011. As shown by British Airways' decision, the IASIP can serve as a potent incentive for airlines to institute new air services between San Diego and unserved international airports.

An airline instituting new international air service bears significant start-up costs. In today's harsh financial environment, air carriers are reluctant to introduce new air service unless they have confidence that they will be able to recover incurred start-up costs. Staff's experience with British Airways indicated two deficiencies with the current IASIP program:

1. *Unrestricted Availability of the IASIP Inhibits Institution of Service to New International Destinations.* The current IASIP program permits up to five applications for IASIP benefits each year regardless of the market served. This gives rise to the potential that after one airline qualifies for IASIP benefits by initiating a new, international, air service from San Diego, a second airline could qualify for IASIP benefits by instituting air service to an airport serving the same market region before the first airline has had an opportunity to recover its startup costs. An example would be an airline instituting air service between San Diego and Hong Kong and then a second airline thereafter proposes to initiate service to Bangkok. This potential new service undermines the appeal of the IASIP to the first airline initiating international air service because the availability of IASIP to a second airline disrupts the first airline's load projections and recovery of start-up cost calculations. The resulting uncertainty discourages the first airline from initiating international service to the new destination.

2. *Lack of Flexibility Impedes IASIP Ability to Meet Emergent Market Needs.* International air service markets are characterized by constant change. As currently designed, the IASIP applies only to identified regions. As a result, the IASIP lacks the flexibility needed to readily respond to changes in the international air service markets. Increased flexibility in the program's application to market requirements will provide the maximum return for the dollar while best attaining the Authority's goal to increase penetration of the international air service markets.

Proposed Revisions to International Air Service Incentive Program

The proposed revisions resolve the identified deficiencies by replacing the current IASIP's broad regional approach with a "targeted" approach and by authorizing the President/CEO to amend the list of IASIP qualifying regions and airports to meet market needs. When an air carrier institutes air service to a qualifying target region or airport, the destination would be removed from the IASIP qualifying list for three years. This revision will promote air service to new international destinations while avoiding the dilution of incentives associated with having two airlines using IASIP benefits simultaneously to serve the same region. The President/CEO would provide written notification to the Board of each change to the list of qualifying regions/airports. Significantly, the proposed revisions do not change the IASIP's financial components or route of flight requirements.

Attached as "Exhibit A" is the current IASIP with proposed revisions as redlined changes. "Exhibit B" is the proposed IASIP without redline.

Fiscal Impact:

No change to the IASIP budget is proposed. Following the period in which IASIP benefits and waivers are utilized by an air carrier, the revised IASIP will likely increase the Authority's revenues as a result of the institution of each new international air service. The amount of the increase will be a function of the specific air service.

Environmental Review:

A. CEQA: This Board action is not a project that would have a significant effect on the environment as defined by the California Environmental Quality Act (CEQA), as amended. 14 Cal. Code Regs. §15378. This Board action is not a "project" subject to CEQA. Cal. Pub. Res. Code §21065.

B. California Coastal Act: This Board action is not a "development" as defined by the California Coastal Act, Cal. Pub. Res. Code §30106.

Equal Opportunity Program:

Not Applicable

Prepared by:

HAMPTON BROWN
DIRECTOR, AIR SERVICE DEVELOPMENT

RESOLUTION NO. 2011-0034

A RESOLUTION OF THE BOARD OF THE SAN DIEGO COUNTY REGIONAL AIRPORT AUTHORITY REVISING THE AUTHORITY'S INTERNATIONAL AIR SERVICE INCENTIVE PROGRAM

WHEREAS, the Authority instituted its International Air Service Incentive Program ("IASIP") in October 2007 to attract air service between the San Diego International Airport ("Airport") and unserved international destinations; and

WHEREAS, the IASIP has been proven to be effective in attracting new international air service to San Diego; and

WHEREAS, recent experience indicates the effectiveness of the IASIP may be increased by revising the program's application to a more targeted approach and by increasing the program's flexibility to handle changes in the evolving international air service market; and

WHEREAS, the Board finds that revising the IASIP to avoid dilution of the program's incentives and to better meet the evolving market needs of the international air service industry will increase the IASIP's effectiveness in attracting new international air service to the Airport and is in the best interests of the Authority; and

WHEREAS, this Board action is not a project that will have a significant effect on the environment as defined in the California Environmental Quality Act ("CEQA"), as amended, and does not constitute a "project" as defined in CEQA. [Cal. Pub. Res. Code §21065; 14 Cal. Code of Regs. §15378]; and

WHEREAS, this Board action is not a "development" as defined by the California Coastal Act. [Cal. Pub. Res. Code §30106].

NOW, THEREFORE, BE IT RESOLVED that the Board hereby approves and authorizes the revised IASIP, a copy of which is attached hereto as "Exhibit A"; and

BE IT FURTHER RESOLVED that the Board authorizes and delegates authority to the President/CEO to modify the regions and qualifying airports on the International Incentive Program Qualifying Regions List, from time to time, using a targeted region/airport approach, to meet changing air service market conditions where such revisions do not change the IASIP's existing financial components or flight requirements; and

BE IT FURTHER RESOLVED that the Board directs the President/CEO to inform the Board on a timely basis of any changes to the IASIP's targeted regions and/or airports; and

BE IT FURTHER RESOLVED that the Board hereby approves and adopts the above findings and recitals stated in this resolution.

PASSED, ADOPTED AND APPROVED by the Board of the San Diego County Regional Airport Authority at a regular meeting this 3rd day of March, 2011 by the following vote:

AYES: Board Members:

NOES: Board Members:

ABSENT: Board Members:

ATTEST:

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TONY RUSSELL
DIRECTOR, CORPORATE
SERVICES/ AUTHORITY CLERK

APPROVED AS TO FORM:

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BRETON K. LOBNER
GENERAL COUNSEL

EXHIBIT A
INTERNATIONAL AIR SERVICE INCENTIVE PROGRAM (IASIP)

~~**BACKGROUND**~~

~~Long-haul international air service is a key element of a vibrant regional economy. While San Diego is the second largest city in California, it handles none of the 78 roundtrip flights per day between California and Europe / Asia.~~

~~International airlines are increasingly selective in which markets they deploy scarce aircraft resources. Start-up costs play a critical role in the decision making process as to which markets to serve. This development has affected the airport-airline relationship. International airports such as Portland (OR), Seattle, and Denver have instituted incentive programs to attract new international air service.~~

~~SDIA faces even more hurdles in attracting international air service to this region due to the following factors:~~

- ~~SDIA's topographic position impacts the airline's choice of aircraft, range for nonstop operation and payload.~~
- ~~The last international airline to serve San Diego, British Airways, ceased service in 2003 and this has left the impression of market unsustainability.~~

~~Some international airlines wanting to depart San Diego fully loaded are therefore required to consider SDIA in the context of an intermediate stop, which requires an extra landing and take-off. This extra procedure may add additional expense to the journey cost and may not add revenue to their bottom line. This places SDIA marketing efforts at a distinct disadvantage when compared to other airports in this region.~~

~~**STRATEGIC OBJECTIVES**~~

~~The International Air Service Incentive Program is consistent with the mission of the SDCRAA to:~~

- ~~*Provide air transportation services to the region:* In the end, the incentive program's intent is to help San Diego travelers reach their destination in a more direct and efficient way.~~

- ~~*Promote the region's prosperity:* New international routes will only add to San Diego's prosperity by making the region more competitive in international business, conventions and tourism. New international routes to and from San Diego will result in a profound annual economic impact (estimated in excess of $100 million per annum). The San Diego region would see direct and indirect impacts from economic stimulus of new visitors.~~

PURPOSE OF IASIP

The purpose of the IASIP is to enhance the air service marketing efforts of San Diego International Airport and make the airport more competitive in attracting valuable overseas air service. The

IASIP provides financial incentives to qualifying air carriers that initiate air service between San Diego International Airport and targeted unserved overseas markets.

~~SCOPE OF PROGRAM~~IASIP REQUIREMENTS FOR QUALIFICATION AND INCENTIVE DESCRIPTION

1. **Program Qualification and Requirements:** In order to qualify for participation in the Program, the following conditions apply:

- The international airport of destination in Europe, Central / South America, Asia, Oceania or Africa is un-served from SDIA and is included on the IASIP list of qualifying destinations~~.~~
- Service to Europe, Central or South America must be nonstop or triangular (e.g. Dublin – San Diego – San Francisco – Dublin). Triangular operations are permitted so long as one directional sector to/from San Diego and target continent is operated nonstop.
- Service to Asia, Africa or Oceania must be nonstop, triangular or single-same plane direct (one-stop). Triangular operations (e.g. Seoul – San Diego – Las Vegas – Seoul) are permitted so long as one directional sector to/from San Diego and target continent is operated nonstop. In the case of one-stop (direct) operations to Asia, Africa, or Oceania, aircraft registration number and flight number must remain the same on all sectors and first stop must be outside the USA (e.g. Vancouver, Papeete etc.).
- The service is operated with a minimum of two scheduled roundtrips each week and provides consistent year-round service.
- Service is operational for a minimum of one year.
- The airline, its subcontract, partner or alliance airline, has not served the same route or destination city within the past 18 months.
- No more than five (5) new services can qualify for the Incentive Program in each year.

2. **Program ~~Qualifications~~Incentives:** The International Air Service Incentive Program has been developed to be competitive with other airport programs and balances the interests of existing carriers and potential carriers. The program is available to all airlines currently at the airport or those wishing to start service at the airport. The program contains three parts.

- ***A Temporary Landing Fee Waiver*** – The landed weight for qualified new trans-oceanic / international flights shall be waived 100% for the first 12 months and reduced by 50% in the second 12 month period of operation at SDIA. Airlines qualifying for this incentive shall be responsible for filing a monthly landing fee report (at current rates) with fees based on the Minimum Landed Weight (MLW) of the aircraft utilized. The landing fees remitted to the Authority will be refunded to the airline semi-annually upon the airline meeting all Incentive Program requirements.
- ***A Temporary Exclusive-Use Rent Rebate*** The exclusive rental rates for new trans-Oceanic service shall be waived 100% for the first 12 months and reduced by 50% in the second 12 month period of operation at SDIA. For incumbent airlines, exclusive terminal rents shall be discounted proportionately based on the number of enplaned passengers using the new service as compared to the number of passengers using all of its other

flights. Airlines shall remit all rental fees to the Authority, which will be refunded semi-annually upon the airline meeting all Incentive Program requirements. All airlines participating in the Incentive Program, however, shall remain responsible for payment of terminal joint-use and security charges.

- ***Marketing Program*** – The participating airlines that wish to market the San Diego service may qualify for up to $500,000 marketing assistance in the first year of new service and up to $250,000 in the second year of service. Marketing assistance will be subject to editorial oversight by the SDCRAA and all funds utilized for this purpose will be pre-approved by the SDCRAA and advertise service specific to San Diego. Should service be suspended prematurely, airline shall be responsible for reimbursement of all marketing funds spent.

Program Qualifications ~~– Trans-Oceanic Service~~

QUALIFICATIONS	REQUIREMENTS
Qualifying Airlines:	All Airlines (incumbent and new entrant)
Qualifying Markets:	Any airport included on the qualifying regions / airports list
Route Qualifications: *for service between SAN and Europe, Central* or South America*	*Nonstop or triangular route*
for service between SAN and Asia, Oceania or Africa	*Nonstop, triangular or single-plane one-stop***

* - Central America does not include Mexico or the Caribbean.

** - for single-plane one-stop service to qualify, service must be offered with the same flight number and all sectors must operate with the same aircraft registration number and aircraft type in each direction. For single-plane one-stop service, first stop must be outside of the United States (e.g. Vancouver, Canada; Papeete, Tahiti etc.).

~~JUSTIFICATION:~~

- ~~Airports such as BWI, Minneapolis, Seattle, Portland, San Jose, and Miami offer exclusive terminal space rent incentives for a specified period of time.~~
- ~~Denver, Oakland, San Jose, Portland (OR) and Seattle have offered or continue to offer temporary landing fee waivers or its equivalent for new international routes.~~
- ~~Many firms in San Diego rely on quick and efficient air service from San Diego to Europe and Asia. Fortune 500 companies such as Qualcomm continue to expand their presence overseas.~~
- ~~Marketing assistance for new international air service is an industry standard practiced by airports nationwide. (Denver and Phoenix typically offer marketing incentives in the millions).~~
- ~~The International Air Service Incentive Program will mitigate the cost pressure to qualifying airlines in the critical first year of service, when business risk is the greatest. The risk generally occurs at the beginning of operations when the airline is expending considerable funds to establish its local station, maintain consistent ridership, and establish their name in the local market.~~

- ~~The International Air Service Incentive Program for SDIA is consistent with FAA regulations and has been presented to the FAA without objections.~~

~~FINANCIAL IMPLICATIONS~~

~~Landing Fees~~

~~Introducing a landed fee waiver on an interim basis will impact the Authority landing fee revenues. The Authority typically collects 100% of its airfield costs and the program would waive the new carrier's share of these costs. A daily wide body service will likely contribute over $300,000 of landing fee revenue annually; half this revenue will be realized in year two of the new operation and 100% in year three of the operation. This revenue loss will be funded from non-airline revenues. For airlines currently providing service at SDIA, any new service developed under this program will immediately reduce the existing carrier's share of the airfield costs and will contribute to a lower airline cost per enplaned passenger at SDIA.~~

~~Exclusive-Use Rents~~

~~Exclusive-use rents would be 100% rebated in year one, however 50% exclusive-use revenue would be realized in year two with 100% recovery of exclusive-use rents in year three of the service. To the extent the new service provider operates from existing space leased to another carrier or occupies currently vacant space, this waiver will have no negative impact on terminal rental revenue. While the Authority is foregoing the opportunity to increase its terminal revenue, it is highly unlikely this opportunity would exist without the Incentive Program.~~

~~PFC Revenues~~

~~PFC revenues will benefit from this program as new service stimulates new passengers or recaptures passengers that had typically driven to LAX for international flights.~~

~~Concession Revenue~~

~~Concession revenue will be positively impacted by this program through the generation of incremental concession revenue. As new service stimulates new passengers or recaptures passengers that typically had previously driven to LAX for international flights, these passengers will be using SDIA's public parking lots, renting cars, and buying terminal concessions.~~

~~Joint Use / Security~~

~~Joint-use and security fees collected by the Authority would not be impacted by this program. The existing carriers will benefit from lower costs immediately as the new service providers will pay their fair share of these fees upon commencement of service.~~

~~Joint Marketing~~

~~The Authority's joint marketing program has existed for many years for all carriers at SDIA. As is the custom for new services at many airports, the Authority has provided additional funds to organize inaugural activities and initial ramp-up of the promotional and educational projects for a new international service. While some airports provide a significant marketing incentive for a new carrier (e.g., Denver $1.5 million), the proposed program envisions a modest $500,000 for the first year and $250,000 in the second year. Marketing funds are available to any carrier opening new destinations at SDIA and many domestic/incumbent carriers have already utilized this incentive.~~

~~Since the marketing expenditure will not benefit all air carriers, the higher joint marketing program costs will be funded from the Authority's non-airline revenues.~~

~~*Financial Summary*~~

~~Landing fee revenue will be negatively impacting during the two year incentive period. All other airline derived revenues such as terminal joint use, and security charges will not be impacted by this program. From the third year forward, the new service provider would fully contribute to airlines revenues. Starting immediately, the costs allocation assigned to the new carrier will, whether funded by the Authority or the new carrier starting in year two, lower revenue contributions from all other carriers to SDIA.~~

~~PFC and non-airline revenue such as public parking, rental car privilege fees, and terminal concessions will generate incremental concession revenue immediately. Depending on the frequency of service and the nature of the market, this additional revenue will help to offset the Authority's loss of revenue from waived landing fees and higher joint marketing costs. In the short term, however non-airline revenue will fund the remaining portion not covered by the additional revenues.~~

SAN DIEGO INTERNATIONAL AIRPORT
INTERNATIONAL INCENTIVE PROGRAM QUALIFYING REGIONS LIST
(EFFECTIVE DATE MARCH 3, 2011
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Region	Qualifying Airports
AFRICA	Any airport in Africa
ASIA	Any airport in Asia
EUROPE	None
CENTRAL AMERICA	Any airport in Central America
SOUTH AMERICA	Any airport in South America
OCEANIA	Any airport in Oceania

Determined and Approved:

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President / CEO
SDCRAA

EXHIBIT B
INTERNATIONAL AIR SERVICE INCENTIVE PROGRAM (IASIP)

PURPOSE OF IASIP

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Program Qualifications

QUALIFICATIONS	REQUIREMENTS
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for service between SAN and Asia, Oceania or Africa	*Nonstop, triangular or single-plane one-stop***

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SAN DIEGO INTERNATIONAL AIRPORT
INTERNATIONAL INCENTIVE PROGRAM QUALIFYING REGIONS LIST
(EFFECTIVE DATE MARCH 3, 2011)

Region	Qualifying Airports
AFRICA	Any airport in Africa
ASIA	Any airport in Asia
EUROPE	None
CENTRAL AMERICA	Any airport in Central America
SOUTH AMERICA	Any airport in South America
OCEANIA	Any airport in Oceania

Determined and Approved:

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President / CEO
SDCRAA