SAN DIEGO COUNTY
REGIONAL AIRPORT AUTHORITY

STAFF REPORT

Item No. 6

Meeting Date: **FEBRUARY 9, 2012**

Subject:

Revise the Authority's North American Air Service Incentive Program to Extend the Program's Domestic Landing Fee Credit

Recommendation:

Adopt Resolution No. 2012-0011, authorizing an extension of the Authority's North American Air Service Incentive Program Domestic Landing Fee Credit.

Background/Justification:

Current Domestic Air Service Program Status

At its September 2009 meeting, the Board authorized the establishment of the Authority's North American Air Service Incentive Program ("ASP") to encourage airlines to develop nonstop air service between San Diego and new destination airports in the US, Mexico, and the Caribbean. The program contains two distinct incentives: (1) Landing Fee Credit, and (2) Marketing Incentive. The Marketing Incentive for the US, Canada, Mexico and the Caribbean is in effect and carriers continue to utilize this incentive. The landing fee credit for new Canadian, Mexican or Caribbean destinations is a two year incentive that credits landing fees paid by carriers for new services added - 100% in the first year and 50% in the second year of service. This credit is in effect and carriers continue to utilize this incentive (e.g. Volaris). However, the landing fee credit incentive for new domestic destinations expired on December 31, 2010.

The domestic landing fee credit was offered as a limited time trial (between September 4, 2009 and December 31, 2010) to enhance the Authority's incentives for increasing the number of domestic destinations serving the airport. During the trial period two airlines qualified for the credit with Alaska Airlines service to Maui and Southwest service to St. Louis.

Over the last decade, the airline industry has progressively removed aircraft capacity from the domestic market. San Diego has recently experienced this trend from our peak in 2008. In fact between January 1, 2011 and December 31, 2011 there were no new domestic destinations that would have qualified for a landing fee credit. Some of the recent capacity reductions have been as a result of airline closures or mergers and overall weakness in the national economy. This means that scarce domestic airline capacity being sought by airports is extremely competitive.

Proposed Revisions to the North American Air Service Program.

The proposed revision renews and extends the validity period of the domestic landing fee credit to December 31, 2014 in order for the Authority to remain competitive in air service development.

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

Fiscal Impact:

Landing Fees

Extending the landing fee credit on an interim basis will impact the Authority landing fee revenues. The Authority typically collects 100% of its airfield costs and the Program would rebate the costs attributed to the new service. An average daily domestic flight (737) will likely contribute over $90,000 of landing fee revenue annually. Under the Program 100% of the revenue would be realized by the second year of operation. The revenue loss in the first year of operations will be funded from non-airline revenues. For airlines currently providing service at SDIA, any new service developed under the Program will immediately reduce the existing carriers' share of the airfield costs and will contribute to a lower airline cost per enplaned passenger at SDIA.

PFC Revenues

PFC revenues would be expected to increase from this Program if new service stimulates new passengers or recaptures passengers.

Concession Revenue

Concession revenues will be positively impacted by the Program through the generation of incremental concession revenues. Newly commenced air services stimulate new passengers or recaptures passengers.

Rental Space / Joint-Use / Security

Rental Space, joint-use and security fees collected by the SDCRAA would not be impacted by the program. The existing carriers will benefit from lower costs immediately as the new service providers will pay their fair share of these types of fees upon commencement of service.

Financial Summary

Landing fee revenues will be negatively impacted during the first year incentive period. All other airline derived revenues such as rental space, terminal joint use, and security charges will not be impacted by the Program. From the second year forward, the new service would start contributing to airfield revenues. Starting immediately, the costs allocation assigned to the new service will, whether funded by the SDCRAA or the carrier starting in year two, lower revenue contributions from all other carriers to SDIA.

Non-airline revenue such as public parking, rental car privilege fees, and terminal concessions will generate incremental increased concession revenues immediately. Depending on the frequency of service and the nature of the market, this additional revenue will help to offset the SDCRAA's loss of revenue from landing fee credits. In the short term, however, non-airline revenue will fund the remaining portion not covered by the additional revenues.

Authority Strategies:

This item supports one or more of the Authority Strategies, as follows:

☒ Community Strategy ☒ Customer Strategy ☐ Employee Strategy ☐ Financial Strategy ☐ Operations Strategy

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. 2012-0011

A RESOLUTION OF THE BOARD OF THE SAN DIEGO COUNTY REGIONAL AIRPORT AUTHORITY AUTHORIZING EXTENSION OF THE AUTHORITY'S NORTH AMERICAN AIR SERVICE INCENTIVE PROGRAM DOMESTIC LANDING FEE CREDIT

WHEREAS, the Authority instituted its North American Air Service Incentive Program ("ASP") in September 2009 to attract air service between the San Diego International Airport ("Airport") and unserved domestic, Mexican and Canadian destinations; and

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

WHEREAS, the domestic landing fee credit for new air service contained within the ASP expired in December 2010, and

WHEREAS, recent economic conditions and cuts in domestic airline capacity require a robust incentive portfolio for attracting new domestic air service to San Diego; and

WHEREAS, the Board finds that extending the ASP domestic landing fee credit will better meet the evolving market needs of the domestic air service industry and will increase the ASP's effectiveness in adding new domestic destinations to the Airport and is in the best interests of the Authority; and

NOW THEREFORE BE IT RESOLVED that the Board hereby amends the ASP, authorizing the extension of the ASP domestic landing fee credit to December 31, 2014 (Exhibit A); and

BE IT FURTHER RESOLVED that the Board of the San Diego County Regional Airport Authority finds that this Board action is not a "project" as defined by the California Environmental Quality Act (CEQA) Pub. Res. Code Section 21065; and is not a "development" as defined by the California Coastal Act Pub. Res. Code Section 30106; and

BE IT FURTHER RESOLVED that the Board hereby ADOPTS the above recitals for incorporation in this resolution.

PASSED, ADOPTED AND APPROVED by the Board of the San Diego County Regional Airport Authority at a special meeting this 9th day of February, 2012, by the following vote:

AYES: Board Members:

NOES: Board Members:

ABSENT: Board Members:

ATTEST:

TONY RUSSELL
DIRECTOR, CORPORATE SERVICES
AUTHORITY CLERK

APPROVED AS TO FORM:

BRETON K. LOBNER
GENERAL COUNSEL

EXHIBIT A

SAN DIEGO - NORTH AMERICAN AIR SERVICE INCENTIVE PROGRAM

The North American Air Service Incentive Program (the "Program") is consistent with the mission of the San Diego County Regional Airport Authority ("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 routes enhance airport revenues and have downstream impacts to the local region.

SCOPE OF NORTH AMERICAN AIR SERVICE INCENTIVE PROGRAM

The Program has two distinct components:

1) A landing fee credit ("Credit") to encourage flights from SDIA to new destinations, and

2) A marketing incentive ("Incentive") for additional flights from SDIA to new or existing destinations.

Program Requirements: In order to qualify for participation in the Program, the following conditions apply:

Requirements for Landing Fee Credit:

- To qualify for the Credit, the Airline must operate the route year -round to a new destination airport in the United States, Mexico, Bermuda, the Bahamas, the Caribbean or Canada.
- Only new destinations qualify for the credit.
- Only one annual Credit exists for each new destination.
  The first carrier to commence operations on the new route to the San Diego International Airport will be the qualifying carrier. Should two (2) or more airlines commence the same qualifying service within a three-month period of the qualifying carrier, the single Credit percentage shall be equally divided among the carriers commencing service and continuing service for one year.
- The carrier(s) must operate the route for a minimum of one (1) year. If the carrier(s) fails to operate the route for one (1) year, the carrier(s) shall not receive the Credit.

- A maximum of seven (7) weekly frequencies (one daily frequency) can be credited per market for an airline; additional frequencies in the same market by one airline do not qualify.
- Each airline must have a minimum of two (2) weekly departures (annual average) to the destination airport in order to qualify for the Credit. Airlines may not cumulatively total their operations to qualify for the Credit.
- Seasonal Service that is extended to year-round service will be eligible for the landing fee credit provided year-round service is announced within the first three-months of start date and service continues for at least one (1) year. In this case, the Credit would be eligible from the original start date provided air carrier had not served the destination within the 18 months prior to start date. "Seasonal Service" shall mean any service that upon announcement: (1) is not operated on a published schedule pattern within every month of the year (January through December) and (2) is operated for more than 90 days but less than 365 days in one calendar year.
- Creditable Landing Fees shall be secured by an airline's filed letter of credit.
- The qualifying air carrier(s) must submit a letter of credit, which in the aggregate must cover at least six (6) months of expected landing fees for the new route.
- Airlines that transfer routes to/from their regional affiliated carriers and sell such routes under their brand shall not qualify for the Credit unless the route was added within the qualifying period of the Program.
- Should service on the route be terminated pre-maturely (before completion of one year), the SDCRAA shall be reimbursed for all landing fee credits committed to the airline for the route.
- A transfer of a flight from one airport to another airport within the same metropolitan area does not qualify. The standard census definitions of metropolitan statistical area (MSA) and consolidated metropolitan statistical area (CMSA) will apply in this case.

Requirements for Marketing Incentive:

- To qualify for the Incentive, the qualifying airline must initiate a new route from SDIA to a destination airport in the United States, Mexico, Bermuda, the Bahamas, the Caribbean or Canada.
- In addition to initiation of a new route, new non-stop flights to existing destination airports will also qualify even if nonstop service is provided by an incumbent carrier.
- New flights to existing destination airports will also qualify if nonstop service is provided by a competitive carrier and this carrier has not provided service to the destination within the past 18 months.
- Airlines that transfer routes to their regional affiliated carriers and sell such routes under their brand shall not qualify for the Incentive unless the route was added within the qualifying period of the Program.
- The route must be operated for a minimum of one (1) year or for Seasonal service routes a minimum of ninety (90) days.
- A minimum of two (2) weekly departures to the destination airport are required.
  Seasonal service qualifies for the Incentive provided it operates for a minimum of ninety (90) days.

- Should service on the route be terminated pre-maturely (before completion of one year or one season), the SDCRAA shall be reimbursed on a pro-rated basis (365 day pro-rate for year-round service and 90 day pro-rate for seasonal service) for all Incentives invested.
- A transfer of a flight from one airport to another airport within the same metropolitan area does not qualify. The standard census definitions of metropolitan statistical area (MSA) and consolidated metropolitan statistical area (CMSA) will apply in this case.

Program Outline: The 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 SDIA or those wishing to start service at SDIA.

- ***A Temporary Landing Fee Credit for a maximum of one (1) daily flight per market –***

First Year of Service:

- Any flight to a new destination airport in Canada, Mexico, the Caribbean, the Bahamas or Bermuda - 100% credit of landing fees for 12 months.
- Any flight to a new destination airport in the United States of America - 100% credit of landing fees for 12 months.

Second Year of Service:

- Any flight to a new destination airport in Canada, Mexico, the Caribbean, the Bahamas or Bermuda - 50% credit of landing fees for 12 months.

Validity Period of Landing Fee Credit

- For new destination airports in the United States, the landing fee credit incentive program shall only be valid for new routes to destinations not already being served and commenced between ~~September 4, 2009 and December 31, 2010~~February 9, 2012 and December 31, 2014, unless renewed by the SDCRAA Board of Directors.
- For new destination airports in Canada, Mexico, the Caribbean, the Bahamas or Bermuda, the landing fee credit incentive program shall be ongoing unless cancelled by the SDCRAA Board of Directors.

Provided the airline is not in default and has no rents or fees owing under its Airline Operating Agreement or other agreements it may have with the SDCRAA, the landing fees for the qualifying flight(s) remitted to the SDCRAA will be credited toward future airport rents and/or fees. Should the airline terminate the qualifying service pre-maturely, all credits granted (whether applied or unapplied by the Airline) shall be voided and Airline shall be responsible for full payment of all rents and fees accrued since inception of the qualifying service, as well as any further payments due SDCRAA. The qualifying air carrier must submit a letter of credit, which in the aggregate must cover at least six (6) months of expected landing fees for the new route.

- ***Marketing Incentive –*** Flights to new destination airports will qualify for an Incentive in the first year of service. New flights to existing destination airports will also qualify if nonstop service is provided by a competitive carrier and this carrier has not provided service to the destination within the past 18 months. The Incentives shall be utilized solely for the purpose of promoting the new San Diego route in TV, radio, print and/or internet marketing campaigns. Airlines applying for the Incentive must agree to editorial oversight by the SDCRAA. All marketing materials and/or promotions funded by the Incentive shall be pre-approved in writing by the SDCRAA prior to publication. Incentives utilized for this purpose will be pre-approved by the SDCRAA and will advertise service specific to the new San Diego route. Should service be suspended prematurely, airline shall be responsible for pro-rated (365-day pro-rate for year-round service and 90-day pro-rate for seasonal service) reimbursement of all marketing funds spent. Marketing incentives will only be given upon substantiated invoices from the air carrier.

Methodology of Marketing Incentive

- Any flight to a new international destination airport in Canada, Mexico, the Caribbean, the Bahamas or Bermuda shall qualify for a total marketing incentive not to exceed $60,000 per route.
- Any flight to a new destination airport in the United States shall qualify for a total marketing incentive not to exceed $35,000 per route.
- A new flight to an existing international destination airport (Canada, Mexico, the Caribbean, the Bahamas and Bermuda) in North America offered by a competitor airline shall qualify for a marketing incentive not to exceed $35,000 per route.
- A new flight to an existing domestic destination airport offered by a competitive airline shall qualify for a marketing incentive not to exceed $25,000 per route.
- Computation of the Incentive will be based on the announced schedule. Should the airline materially down-gauge the frequency and/or size of aircraft on the route, surplus marketing funds shall be returned on a pro-rated basis. For the purposes of this policy a material down-gauge shall be construed as a frequency and/or size reduction of greater than 20%. This provision applies only in cases where the route is to a destination in the United States.
- Incentives referenced above shall be calculated based on frequency and size of aircraft, and calculated based on written objective standards as determined by the SDCRAA President/CEO and shall be applied consistently and fairly.
- In addition to any route marketing incentive, any new airline that otherwise meets the criteria for the Incentive by establishing operations at SDIA shall also

receive a new airline marketing incentive of $25,000 and a 50% discount on costs related to the installation of airport directional signage. A new airline shall be defined as any airline that has not offered scheduled service at SDIA within the prior 18 months.

Validity Period

- The Air Service Marketing Incentive Program shall be ongoing unless cancelled by the SDCRAA Board of Directors.

EXHIBIT B

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Provided the airline is not in default and has no rents or fees owing under its Airline Operating Agreement or other agreements it may have with the SDCRAA, the landing fees for the qualifying flight(s) remitted to the SDCRAA will be credited toward future airport rents and/or fees. Should the airline terminate the qualifying service pre-maturely, all credits granted (whether applied or unapplied by the Airline) shall be voided and Airline shall be responsible for full payment of all rents and fees accrued since inception of the qualifying service, as well as any further payments due SDCRAA. The qualifying air carrier must submit a letter of credit, which in the aggregate must cover at least six (6) months of expected landing fees for the new route.

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costs related to the installation of airport directional signage. A new airline shall be defined as any airline that has not offered scheduled service at SDIA within the prior 18 months.

Validity Period

- The Air Service Marketing Incentive Program shall be ongoing unless cancelled by the SDCRAA Board of Directors.