PORT OF SEATTLE
MEMORANDUM

COMMISSION AGENDA **Item No.** 6a

Date of Meeting June 28, 2011

DATE: June 16, 2011

TO: Tay Yoshitani, Chief Executive Officer

FROM: Michael Ehl, Director Aviation Operations
Kazue Ishiwata, Air Services Development Manager

SUBJECT: Revised Incentive Program for New Commercial Air Service for Seattle-Tacoma International Airport

ACTION REQUESTED:

Request authorization for the Chief Executive Officer to implement a revised incentive program for new commercial air service for Seattle-Tacoma International Airport (Airport) to be consistent with the recently-published Federal Aviation Administration (FAA) guidelines.

SYNOPSIS:

The primary purpose of this action is to adjust the time period of the Airport's incentive program and modify eligibility requirements to be in compliance with the FAA guidelines. Recent FAA publications have shortened the incentive period to either one or two years rather than three years. The financial levels and benefits associated with the incentives for new air service were previously authorized by the Commission and those total financial levels remain unchanged.

The Port of Seattle Commission authorized implementation of the Airport's new air service incentive program initially in December 2005, and subsequently granted revisions to modify it through several additional action items between 2007 and 2009. The objective of the incentive program is to encourage airlines to initiate international services along new routes, additional international services to existing destinations, and regional services to small communities. It has been successfully utilized by the Airport since Air France began its Paris nonstop operation in 2007, followed by several other new services that the Airport gained, such as Frankfurt service by Lufthansa (2008), Beijing service by Hainan Airlines (2008), Reykjavik service by Icelandair (2009) and Osaka service by Delta Air Lines (2010).

The program has proven to be an effective tool in final inducement in the carriers' decision-making processes. It has also contributed to building strong partnerships with airline customers providing valuable new air services to the region and supports economic development, trade and international tourism by helping to connect Washington state to the rest of the world and create jobs.

This memo requests retention of the core program elements as previously authorized, with no significant change recommended. The current proposal outlined in this memorandum compiles multiple earlier revisions into one consistent format. Certain revisions were necessary, without having to alter the key elements, to be consistent with the recently-published FAA guidelines, for federally obligated facilities receiving Airport Improvement Program (AIP) funds.

BACKGROUND:

Efficient air service is vital to Washington State, benefiting the regional community as a whole in facilitating business transactions for corporate travelers and stimulating the tourism industry that creates additional jobs in the region.

Airlines continue to focus on bottom-line costs in their decision-making processes as to which markets to serve. The launch of a new air service requires significant investment risk on the part of the airlines. The ballpark operating cost for a daily trans-oceanic Boeing 777 service is over $100 million annually, depending on many variables such as fuel price, flight distance, operating carrier's base cost, etc.

As a result, it has become a commonly-held practice in the last decade among competing airports to institute incentive programs to attract new commercial air services. Seattle is no exception. Since Air France's new Paris nonstop service in 2007, the Airport has utilized the previously authorized incentive program and developed close partnerships with each of the carriers for mutual benefit in the process.

As we endeavor to focus on key market development in the coming years in a competitive environment, it is necessary to: 1) review and compile the previously authorized program elements in order to maintain an effective program; and 2) incorporate guidance published by the FAA in September 2010, titled *Air Carrier Incentive Program Guidebook: A Reference for Airport Sponsors* in accordance with Federal statutes.

PROJECT JUSTIFICATION:

This program will allow the Airport to compete more effectively in negotiating with prospective carriers in attracting new air services. Each new international air service generates an average of $1.5 million in landing fees and terminal rent revenues annually to the Airport. As the Airport gains new air services, the increased activities and resultant revenues produce a long-term reduction of the overall airport costs, which benefits the existing carriers. The proposed revision is also required in order to comply with the FAA guidelines in the recently published *Air Carrier Incentive Program Guidebook* mentioned above.

PROJECT STATEMENT AND OBJECTIVES:

Project Statement:

The Airport's air service incentive program provides participating airlines with risk mitigation in the start-up cost through fee waivers and marketing support that is designed to secure new air services and assist them in their initial phase in Seattle.

Project Objective:

To develop and increase strategically beneficial air services at the Airport to generate incremental revenues to the Aviation Division, and to stimulate and facilitate our region's growing economy.

PROJECT SCOPE OF WORK AND SCHEDULE:

Scope of Work:

The incentive program has been devised to balance the needs of attracting new additional service and of the interests of existing carriers. To this end the program is composed of three parts.

Program Structure

Part I Incentive: Discounted international arrival facility charge from the standard rate
Part II Incentive: Temporary waivers of landing fee and terminal facility charge
Part III Incentive: Joint marketing program

Service Category and Program Eligibility

While all international carriers equally benefit from Part I Incentive, the specific level of Part II and Part III incentives varies depending on the category of new services provided. Each category is described below as Category A through D.

Category	Description	Examples
Category A	International nonstop air service of 4,000 miles and longer to an unserved new city	• Paris by Air France in 2007 • Frankfurt by Lufthansa in 2008 • Beijing by Hainan Airlines in 2008 • Osaka by Delta Air Lines in 2010
Category B	International nonstop air service of 2,000 miles to less than 4,000 miles to an unserved new city	• Mexico City by Aeromexico in 2007 (discontinued in 2009) • Reykjavik by Icelandair in 2009
Category C	New competitive international air	• Beijing by Delta Air Lines in 2010

	service of 4,000 miles and longer on an existing route	
Category D	Small community air service	Unserved destinations in Washington, Oregon or Idaho

Previous authorization divided the category by the aircraft type (widebody air service and narrowbody air service). The FAA recently clarified prohibition of incentives based on the aircraft type or number of seats provided by the air carrier, but approves of the categorization by the specified distance as above.

To be eligible as a new international air service for Category A, B and C, the route must be:
- A nonstop service for eligible destinations;
- A minimum of three scheduled round trips each week via any aircraft type;
- Year-round scheduled service sold to the public;
- Not served by the same carrier or its subcontract partner carrier and canceled within 36 months;
- Not considered a replacement service of another route served by profit-sharing Joint Venture agreement carrier on the same city pair.

To be eligible as a new small community air service for Category D, the route must be:
- A nonstop service for unserved destinations in Washington, Oregon or Idaho;
- A minimum of a daily scheduled round trip via any aircraft type;
- Year-round scheduled service sold to the public;
- Not served by the same carrier or its subcontract partner carrier and canceled within 36 months;
- Not considered a replacement service of another route served by profit-sharing Joint Venture agreement carrier on the same city pair.

If a carrier defaults in any of its financial obligations to the Port of Seattle, the incentive benefit privilege will terminate.

Program Description

Part I Incentive: Discounted International Arrival Facility Charge from the Standard Rate

As previously authorized in November 2006, the Airport may apply at its sole discretion its non-aeronautical revenues to adjust the rates of the international arrival facility charges on an annual basis in order to remain competitive in the air service market. Without this credit to the standard charge, the Airport's charge is disproportionately high compared with that of peer airports, putting us at the disadvantage and discouraging existing carriers from potentially adding capacity.

Eligibility applies to all existing and new international services arriving via the Airport's facility encompassing the Federal Inspection Services. This program benefits all carriers equally and has encouraged existing carriers to add new frequencies or up-gauge the aircraft to accommodate growth with additional passengers. Supporting existing carriers is equally valuable and beneficial to the Airport, as evidenced this summer with over 16% seat capacity increase vs. last summer for Asia and Europe on existing services only.

Part II Incentive: Temporary Waivers of Landing Fee and Terminal Facility Charges

Part II Incentives apply to the following categories of new air services.

	Landing Fee Waived		International Arrivals Facility Fee Waiver		Common Use Aircraft Gate and Lobby Fees	
	Year 1	Year 2	Year 1	Year 2	Year 1	Year 2
Category A	100%	75%	75%	75%	N/A	N/A
Category B	75%	N/A	75%	N/A	N/A	N/A
Category C	N/A	N/A	N/A	N/A	N/A	N/A
Category D	100%	100%	N/A	N/A	100%	100%

The incentives amount and timeline above remain the same as previously authorized. These incentives alleviate cost pressure for the new carrier for the period of time when the business risk for them is highest. Typically, this risk is highest in the first two years when they are establishing local operations, and a visible presence in the market, and working to attract and retain consistent passenger load factors through all seasons of the year.

Part III Incentive: Joint Marketing Program

The Airport's Joint Marketing Program has existed for many years for all international carriers. As is customary for new services at many airports, the Airport provides additional funds to support inaugural activities and initial ramp-up of the promotional and educational projects directed at promoting a new air service.

The larger fund is made available to the carrier with eligible new services but is not to be used as cash subsidy. It is designed to be utilized in partnership with the Airport for the purpose of benefiting the Airport business to raise public and industry awareness of airport facilities and services in conjunction with the new air services. In order to utilize the funds, an airline submits qualifying proposal that is reviewed and approved by the Airport. The amount of the fund depends on the Service Category.

Service Category	Total of Multi-Year Marketing Fund	Usage Timeline
Category A	$455,000	2 years, not to exceed 3 budget years
Category B	$200,000	2 years, not to exceed 3 budget years
Category C	$200,000	1 year, not to exceed 2 budget years
Category D	N/A	N/A

Previous authorization allowed the same amount of marketing fund to spread into a three-year period. Per recently published guidelines, the FAA specifically requires the incentive period to be limited to two years for each qualifying new air service (Category A and B). It also limits the duration of the incentive period to one year for a new carrier's service where the incumbent already serves the same route (Category C). The proposed change is to retain the total multi-year benefit at the same level as previously authorized, but compress the timeline to comply with the FAA guidance.

Schedule:

To be eligible for this incentive program, the new air service must be announced and become publicly available prior to the termination of the current Signatory Lease and Operating Agreement (SLOA). The current SLOA includes provisions of the incentive program for passenger air services. As the SLOA is set to expire on December 31, 2012, we intend to revisit and review with the Commission the effectiveness of this program before including similar provisions in the renewed agreement. However, the carrier does not have to be a signatory carrier to be eligible for the incentive benefit.

FINANCIAL IMPLICATIONS:

The incentive program is focused on offering reductions for landing fees and terminal facility charges. Fee waivers are a low-risk investment as they are offset by the generation of new overall revenues associated with the start of new service. Since both rates are set to recover operating and capital costs, additional volume (i.e., more passengers, more landed weight) serves to reduce the rate for all airlines.

1) Part I Incentive: Discounted international arrival facility charge

In 2011 budget year, approximately $7 million of non-aeronautical revenue was utilized to offset the disproportionately high international arrival facility charge as a credit to the standard charge. The goal is to make the Airport's cost more competitive with other West Coast airports. The annual budget decision is approved by the Commission every budget cycle since the 2007 budget year.

2) Part II Incentive: Temporary waivers of landing fee and terminal facility charge

Providing a landing fee waiver temporarily has no impact on cost per enplanement as no existing revenue would be lost by it. Depending on the aircraft size and frequency, the landing fee charge for a daily wide-body service ranges from $350,000 to $600,000 a year. This amount would be the eventual revenue that will be shared by existing carriers and contributes to the lower cost per enplanement in the long term.

Despite the temporary waiver of fees, the new service ultimately generates additional revenue anticipated at the standard rate, thereby providing benefit to existing carriers as well through a lowered cost per enplanement. In addition, Seattle's trans-oceanic services generally include 15 to 40% of connecting passengers to and from other U.S. cities, which means further stimulation of domestic services and eventual lowering of the cost per enplanement.

If a new air service that received Part II Incentive benefits terminates operations prior to completing at least 24 consecutive months of operations, the Port of Seattle reserves the right to recoup the waived landing fee and terminal facility charge.

3) Part III Incentive: Joint marketing program

While some airports such as Portland and Denver provide a significantly larger amount for a new international service at over $1 million, our current level of support has proven to be effective in working in close partnership with customer airlines. The original combined amount of $200,000 for three years, as was approved in December 2005, was not attractive enough to induce the final decision by the carriers and was subsequently raised to the current level of maximum $455,000 combined, as authorized in 2007.

Source of Funds

Only Part III Incentive of the joint marketing program requires funding, which is budgeted annually as new eligible services are anticipated to occur. If a new air service becomes apparent after the budget for the year is finalized, then a contingency fund request for the applicable amount would be made.

Financial Analysis Summary:

Below is an example of a fee waiver structure based on a daily A330-200 service with 243 seats at 2011 rates for the first year of trans-oceanic service of more than 4,000 miles, at average 75% load factor:

Airport Charges	Standard Annual Cost to Airlines	Waived %	Waived Amount	Estimate Cost Paid by Airlines
Landing Fee	$ 434,529	100%	$ 434,529	$ 0
Gate/Lobby	$ 483,260	-	-	$ 483,260
International Arrival Facility Charge (per passenger)	$ 273,693	75%	$ 205,270	$ 68,423
International Arrival Facility Charge (fixed charge)	$ 40,030	-	-	$ 40,030
Ramp Tower Fee	$ 2,387	-	-	$ 2,387
Baggage Make-Up	$ 86,034	-	-	$ 86,034
Total (excluding ticket counters and office space rental)	**$1,319,933**		**$ 639,799**	**$ 680,134**

Notes:

- In addition to the above, a new entrant carrier normally requires ticket counter space (at approximately $53,000 annually for six counter positions for three hours at 2011 rate of $8.05 per position), as well as office rental space. Additionally, some carriers either occupy a club lounge space or pay for the usage of the Airport-owned club. An average revenue to the Airport if a carrier pays the standard rate is approximately $1.5 million per year. Waived amount as a result of the Part II Incentive program represents less than half of the standard cost and the Airport still receives the remainder from the new service carrier.
- In the second year, the landing fee waiver decreases to 75%, thereby decreasing the waived amount by approximately $109,000 and increasing the carrier's payment to the Airport by the same amount.

ECONOMIC IMPACTS AND BUSINESS PLAN OBJECTIVES:

The proposed incentive program positions the Airport to be more competitive with other airports in the country and ensures the benefit to the Port and the community, while developing partnership with airline customers.

The program involves relatively small risk and investment on the part of the Airport in return for a significant benefit. The recent announcement by U.S. Department of Commerce, International Trade Administration, Office of Travel and Tourism Industries (OTTI) on the new estimates on overseas visitor arrivals to the U.S. indicates a dramatic rebound for Seattle and Washington State, leading the growth among the nation in 2010 at 32% for Washington State, and 34% for Seattle. The increase in overseas visitor arrivals is attributed to the addition of new international air services linking the region.

STRATEGIC OBJECTIVES:

Adoption of the incentive program for new international commercial air service routes supports the Port's strategies as follows:

- Develop New Business and Economic Opportunities for the Region and the Port: *Provides long-term benefit to the Airport in incremental revenues while stimulating local economy, trade and tourism that lead to job creation.*
- Be a Catalyst for the Regional Transportation Solutions: *Provides vital direct air services that assist and facilitate our region's growing economy.*
- Ensure Airport Vitality: *Provides incentives for additional air services that provide a more stable long-term revenue base.*

ALTERNATIVES CONSIDERED AND THEIR IMPLICATIONS:

- Alternative 1: Implement the revision of the incentive program to continue further with the success of the past several years in attracting new air services, while ensuring the compliance with the recently published FAA guidance. The program would be a valuable tool for the Airport in its efforts to develop new business and it would narrow the balance of competition between the Airport and peers. **This is the recommended alternative.**
- Alternative 2: Do nothing. The current programs would not be consistent with the new FAA guidelines.
- Alternative 3: Abolish the incentive program and stop offering benefit to the airlines. The Airport would be at a serious disadvantage in a competitive environment where other airports have added an incentive and jeopardize the hard-won relationships with airline customers.
- Alternative 4: Enhance or reduce the benefit to the eligible airlines with further modification. The program has been successful at its current level of benefit offered to the airlines, and incurring additional cost would negatively impact the cost of doing business. Reducing the benefit level would be a return to the 2005-2006 situation in which no carrier showed strong interest in the program with its insufficient amount of support to the carrier.

OTHER DOCUMENTS ASSOCIATED WITH THIS REQUEST:

None.

PREVIOUS COMMISSION ACTIONS OR BRIEFINGS:

- On December 13, 2005, the Commission authorized the first request for implementing a new international air service incentive program.
- On November 14, 2006, as part of the 2007 Budget Review, the Commission authorized a credit to the standard charge for the international arrival facilities charge in order to be more in line with other West Coast airports.

- On February 16, 2007, the Commission authorized modifications to the first request of the incentive program and raised the maximum benefit to an air carrier, generally consistent with the current proposal in this memo.
- On April 10, 2007, the Commission authorized revision to the incentive program to include trans-border commercial air service routes at a different benefit level.
- On April 27, 2007, the Commission authorized the implementation of a small community air service incentive program.
- On November 2, 2007, the Commission authorized a modification to the previously approved program by allowing the Joint Marketing Program's fund to be utilized with greater flexibility within the existing cost and timeline limit in multi-years, eliminating the previously defined per-year usage limit.
- On May 5, 2009, the Commission authorized revision to the incentive program to include a narrow-body international air service to Europe, previously not included in the category.
- On June 14, 2011, the Commission was briefed on the Growth of International Air Service at the Airport and Future Facility Requirements for International Travel.