Airport Charges Directive – Consultation & WACC
8 March 2016, Thessaloniki Forum
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Contents

- Latest Industry Trends
- ACI EUROPE Recommended Practices on:
  > Article 6
  > Article 7
  > Article 8
- Weighted Average Cost of Capital
- Taking in the Bigger Picture
Latest Industry Trends
Strong European air traffic growth of +5.2% in 2015

- With new entrants into the ranks of the largest European airports
  > 3rd: Istanbul Ataturk (10th in 2008)  
  > 11th: Moscow SVO (27th in 2008)  
  > 12th Antalya AYT (22nd in 2008)  
  > 14th Istanbul SAW (81st in 2008)

- And since 2008 the established relationship between air traffic & GDP growth is shifting…

1ACI EUROPE Air Traffic Data
Change is in the Air …

The airline industry continues to mature, led by the LCCs

- Moving upmarket
- Growing their fleets
- Planning future strategies

*Ryanair to offer connecting flights for long-haul airlines*

Europe’s biggest discount carrier targets tie-ups as a way to expand its network and boost passenger numbers

© Thu, Sep 17, 2015, 14.11
Change is in the Air …

Much growth continues to come from Gulf & Turkish airlines

- Winter 15 seat capacity to non-European destinations saw net increase of c. 2 million seats
  > Emirates, Etihad, Qatar & Turkish Airlines accounted for 77% of these

- And creating some alliance-building & consolidation in the market

2Analysis of Winter 15 Innovata Schedule Data
Change is in the Air …

Legacies continue to restructure, with some success

- Strong focus on yields in core markets

<table>
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<tr>
<th>Large FSC - % seat capacity change (Winter 15 vrs. Winter 14)³</th>
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<tr>
<td>10%</td>
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<tr>
<td>-5%</td>
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- Those with multi-hub operations in the healthiest position

³ European Regional Airlines Association – Jan 2016 Monthly Markey Analysis
Change is in the Air …

Good news for airline profitability

- Supported by weaker oil prices
Change is in the Air …

But different implications for different airports

- **Hubs connectivity: Winners & Losers**

4ACI EUROPE Airport Connectivity Report 2015
Change is in the Air …

But different implications for different airports

Passenger Traffic Growth 2015

- > 25 m pax: +3.7%
- 25-10 m pax: +6.3%
- 10-5 m pax: +7.1%
- < 5 m pax: +5.5%
- < 5 m pax (no capitals airports): +3.8%

5ACI EUROPE Traffic Data
Change is in the Air …

European airports continue their own transition

- From ‘B to B’ to ‘B to C’

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6Aggregate European airport score for ‘Overall satisfaction with the airport’
Change is in the Air …

European airports continue their own transition

- From passively accepting traffic to **actively chasing**
Change is in the Air …

European airports continue their own transition

- And from public to private

1. 2016 Airport Ownership

2. Annual Passenger Traffic by Airport Ownership Type

\[\text{ACI EUROPE Airport Ownership Report 2016}\]
But some things just seem to stay the same…
But some things just seem to stay the same…

A4E: European travellers fleeced by excessive airport charges

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But some things just seem to stay the same…

ACI Europe accuses A4E of being out of touch with reality

A4E: European travellers fleeced by excessive airport charges
But some things just seem to stay the same…
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Airport industry responds to airport charges allegations by big 5 airlines

Brussels, 17 June 2015: Following remarks released by the CEOs of AirFrance-KLM, easyJet, IAG, Lufthansa Group and Ryanair this morning at a joint press conference in Brussels, the European airport trade association wishes to set the record straight about airport charges.

THE TRUTH ABOUT REGULATION

Airport charges are already regulated at EU level since 2007. The implementation of this regulation has been the subject of an extensive report at European level, as recently as last year. It remains a subject that is regularly monitored by the European Commission.

AIRLINES ALREADY SUBSIDISED BY AIRPORTS

Airlines are NOT paying the full cost of the airport infrastructure they use – far from it. Each year, the revenues collected from airport charges levied on both airlines and passengers fall over £3 billion short of covering airports’ operating expenses. This also means that not one cent of airport capital expenditure is paid for by airlines. This situation reflects the extensive competitive pressures on airports and the fact that airport competition is now a reality across Europe.

GOOD FOR THE CONSUMER?

The airline position contends that reductions in airport charges at major airports across Europe would add over £2 billion to the lucrative airline bottom line. The air passenger would gain the most.

Airline CEOs call for a new revolution in European aviation

ACI Europe accuses A4E of being out of touch with reality

By James Muir - Jan 22, 2016

fleeced by excessive airport charges

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Airport industry responds to airport charges allegations by big 5 airlines

For immediate release 17 June 2015

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GOOD FOR THE CONSUMER?

The airline position contends that reductions in airport charges at major airports have translated into lower fares, which is simply not true. The fact is that the European aviation industry operates under the world’s most competitive airport charges, which is essential for the industry's continued growth and competitiveness.
The Status Quo is Not Sustainable

- While the European aviation sector is in reasonable health overall, the airport-airline dynamic on airport charges remains ridden with conflict
  > In spite of ICAO principles, Airport Charges Directive, national-level regulation & recourse to competition law

- Sustained battles with clients are not in the airport industries’ interests

- European airports recognise their role and responsibilities to improve the situation
  > To deliver better processes and facilitate useful & informative two-way dialogue

- Hence the engagement in creating Recommended Practices for interpretation of Articles 6, 7 & 8 of the Directive
  > However better understanding of consultation & transparency requirements alone will help, but are unlikely to fundamentally shift the current airport-airline dynamic
ACI EUROPE Recommended Practices
ACI EUROPE Recent Work on ACD

ACI EUROPE Recommended Practices (RP) on Articles 6, 7 & 8

- Following extensive discussion by Economics Committee, Airport Charges Taskforce & Policy Committee over 8 month period
  > RP on Articles 7 & 8 approved by ACI EUROPE Board
  > RP on Article 6 to be submitted to ACI EUROPE Board for approval in mid-March 2016

- Challenge
  > Finding RPs which do not conflict with implementation in each Member State

- Objectives
  > Constructive engagement with Thessaloniki Forum to promote reasonable & consistent application of the Directive across the EU
  > Make the most out of opportunities presented by consultation requirements of the Directive
  > First step to help break cycle of conflict between airport & airline?
Article 6 - Consultation & Appeal
Article 6 - Consultation & Appeal

Consultation – Timeline & Info Provision

- **Clear timeline should be provided by airport to participants**
  - Outlining the number and date of meetings, as well as planned dates for distribution of supporting documentation
  - Timeline should be provided with sufficient notice to allow participants to attend

- **Exact timing & number of meetings will depend on the situation**
  - But any timeline should respect the requirements of the Directive (initial proposal 4 months prior to entry into force & final decision 2 months prior)

- **Info provided should be in line with Article 7 of the Directive**
  - See below for ACI EUROPE Recommended Practices on Article 7

- **Ensure airlines have at least 10 working days to review, discuss internally & input their own views on information provided**
  - Feedback may be provided via meeting or written communication
Consultation – Process

- Both airlines and airline representative associations can take part in consultation and receive supporting documentation, but it must be clear who is being represented
  > Representative associations should present mandate signed by the specific airline uses which it is representing in the consultation process
  
  > Where there are diverging views between an airline and its mandated airline-representative, these should be recorded in the meeting minutes
  
  > If a representative association is not representing any specific airline, it should not attend the process.

- It can be very helpful for the ISA to be invited as an observer to the consultation process
  > But essential that any potential appeal is not subsequently undermined
Article 6 - Consultation & Appeal

Consultation – Process (ctd.)

- Primarily language of consultation process should reflect the views of the majority of participants in the room
  > If conducted in national language, the provision of English translations of supporting documentation (info requirements of Article 7) may support the process
  > But final decision document has legal force in some jurisdictions – as a consequence national-language original text will have to take precedence

Appeals

- Constructive engagement in consultation would be encouraged if greater weight given to those appeals which:
  > Are justified with coherent arguments & (where possible) backed by evidence
  > Are made by airlines which have been constructively involved in the consultation
  > Concern issues which were raised during the consultation process
Article 6 - Consultation & Appeal

Appeals - Timeline

- Airport operator published final decision **2 months** before entry into force - Requirement of the Directive

- Airlines have **20 working days** (1 month) to lodge an appeal
  > Proposal – this would allow at least interim ISA decision before date of entry into force

- ISA has **1 month** to make an interim decision - Requirement of the Directive

- Any subsequent final decision of ISA takes **2 months** to come into force
  > Proposal - mirroring initial ‘2 month’ requirement of the Directive
  > Could be accompanied by provisions to rectify for any over/under-recovery of airport charges under interim decision
Article 7 - Transparency
Article 7 - Transparency

General Information

- Provide a clear description of services & facilities covered by the airport charges
  > List separately charges for other aeronautical-related services & facilities, which are not covered by airport charges

- Provide at a minimum a qualitative explanation as to the methodology used to calculate the level of airport charges
  > If there is a regulatory formula then the ISA may be best placed to clarify this

- Provide additional relevant material such as annual reports, ownership information, audited accounts as requested
Article 7 - Transparency

Operating Expenditure (Opex)

- Provide figures for the key 5-6 main areas of opex

- Provision of additional information on the drivers of opex changes can help the consultation process
  > E.g. staffing levels, additional security requirements, service level changes, etc.

- Provide 5 years of data: 1 year of historical, current year’s opex & forecast for 3 years
  > But mature approach required by all parties – forecasts by their nature will change & focus of consultation should remain on the confirmed opex figures that will immediately affect airport charges
Article 7 - Transparency

Capital Costs (Capex)

- Provide details of depreciation method used
  > Including the rational for this methodology, as well as explanation if methodology has changed since previous consultation period

- Use internationally-applied standards of accounting
  > If other standards are used, provide explanation as to why this is the case

- Where applicable, provide explanation as to the composition of the asset base
  > Including details of any revaluations/impairments/sales of assets & subsequent impact upon the asset base

  > Include confirmation as to whether assets under construction are included in the asset base or not

- WACC – addressed later in presentation
Article 7 - Transparency

Aeronautical Revenues

- Provide figures on aeronautical revenues for 5 years
  > 1 historical, current year’s aeronautical revenues & forecasts for next 3 years

- For current year, provide figures for aeronautical revenues received from each individual airport charge

- For 3 future years provide forecast for overall level of aeronautical revenues only
  > Forecasts on revenues from individual charges depend on airline operational decisions – detailed forecasts likely to be incorrect
  > Again, mature approach required by all parties – forecasts by their nature will change & focus of annual consultation should remain on the proposed figures for subsequent year
Article 7 - Transparency

Traffic Forecasts

- Discussions on deviations between traffic forecasts versus actual outturns may support the consultation process
  > Traffic forecasts heavily dependant upon data input from airlines

Airport Networks

- Provide at least a figure for costs at each individual airport which is within the scope of the Directive
  > Greater than 5mppa and/or the largest airport in the country

- Provide breakdown of aeronautical revenue for each airport charge for each airport which is within the scope of the Directive
  > Greater than 5mppa and/or the largest airport in the country
Article 8 – New Infrastructure Consultation
Definition, Scope & Timing

- ‘New Infrastructure’ - facilities resulting from capital expenditure which are financed by airport charges and which include:
  > Investments in new facilities that create additional capacity;
  > Investments in existing facilities to create additional capacity, increased service quality or improved operational efficiency;
  > Investments to comply with regulatory requirements or legal obligations.

- Players should decide locally what investments to focus on
  > But as a general approach, consider focusing on largest projects that account for 60% of the value of the airport’s proposed annual/multi-year capital expenditure programme

- Consultation on new infrastructure should take place before the final decision is made by the airport operator to proceed with the plans
  > E.g. prior to any final approval by the airport operator Board
Article 8 - New Infrastructure Consultation

Consultation Process

- If not taking place as a separate process, consultation on new infrastructure should at least take place as part of the regular consultation process, as outlined in Article 6
  > See ACI EUROPE Recommended Practices on Article 6

- Clear timeline should be provided to participants in advance
  > Outlining the number and date of meetings, as well as planned dates for distribution of supporting documentation
  
  > Timeline should be provided with sufficient notice to allow participants to attend

- Supporting documentation should be provided so as to allow airlines at least 10 working days to review, discuss internally & input their own views
Consultation Process (ctd.)

- Both airlines & airline representative associations can take part in consultation and receive supporting documentation, but it must be clear who is being represented:
  > Representative associations should present a mandate signed by the specific airline users which it is representing in the consultation process
  
  > Where there are diverging views between an airline and its mandated airline-representative, these should be recorded in the meeting minutes
  
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- Consultations should be forward AND backward-looking
  > Previously-discussed investments should also be consulted upon, with explanations provided for deviations from expected outcomes
Consultation Process (ctd.)

- It can be helpful to present the Airport Masterplan to users during the consultation process
  - Provides to participants the context & supporting rationale for individual investments
  - But Masterplan itself cannot become subject to the consultation process

- All consultation meetings should be chaired by the airport operator

- The airport operator should keep minutes of each meeting,
  - These minutes should be made freely available to all participants in the consultation process
Supporting Documentation

- For each project under the scope of the consultation, a ‘Project Summary’ documentation should be provided, detailing
  - Project drivers (e.g. capacity, service quality, regulatory compliance, etc.) and expected output of project
  - Forecast costs of project and forecast impact on airport charges (where relevant)
  - Position of the project within the wider Airport Masterplan
  - Forecast timeline of the project (Construction period, when new infrastructure comes into operational use and -where relevant- when airlines will begin to pay for project)
Supporting Documentation (ctd.)

- Review of recently-completed capex projects should also be provided, where these projects were previously subject to consultation
  > Review should contain assessment as to what degree the original objectives were realised
  > Review should contain specific explanations for project costs which are 10% greater or less than initially forecast
Weighted Average Cost of Capital (WACC)
Weighted Average Cost of Capital

Process

- WACC consultations can be a ‘zero-sum game’
  > Limited incentive for either party to engage constructively

- Potential benefits of focus on WACC by Thessaloniki Forum remain unclear
  > WACC is not specifically addressed in the text of the Directive

Calculations

- Any discussions must be underpinned by strong technical expertise
  > In many instances this will require the involvement of external technical experts

- When considering underlying data, a sufficiently long-term time horizon should be used.
  > Avoid overly-representative of recent shifts in interest rates, financial markets, etc.
  > which might otherwise lead to unnecessary volatility in values for the regulatory WACC
Weighted Average Cost of Capital

Calculations

- Any ‘gearing’ targets should reflect market realities & not just theoretical ideals

- Important that suitable airport benchmarks are used for comparison of beta
  > Assessment of level of traffic volatility a particular challenge

- Factor in correctly the ‘country-risk premium’
  > Very close relationship between an airport’s business and the health of the national economy
  > Public finances can impact airport rating if publically-owned

- Any final WACC figures should be stress tested according to the assumptions that informed the calculations
  > To ensure that the WACC figures do indeed deliver a financial profile to the airport which is sufficient to ensure continued ability to invest back into the infrastructure
Taking in the Bigger Picture
Taking in the Bigger Picture

- In some jurisdictions a healthy & commercial airline-airport dynamic already exists – particularly at smaller airports just within scope of Directive
  - Any additional ‘Guidelines’ or ‘Recommended Practices’ may just undermine this dynamic

- A clearer understanding of the Consultation & Transparency requirements of the Directive will help…
  - But it will not fundamentally change the airport-airline dynamic

- The Opportunity – to work within the Directive to:
  - Focus regulatory efforts where they are most needed
  - De-politicise the issue of airport charges & incentivise both parties to find common commercial interest

- Airport Market Power Tests offer one clear way forward
  - “The Thessaloniki Forum of Airport Charges Regulators (…) will provide the Commission with findings and recommendations on the use of market power assessment as a means of determining the optimal regulatory approach”

8' An Aviation Strategy for Europe’ European Commission, Dec 2015
THANK YOU

www.aci-europe.org
www.airportcarbonaccreditation.org