

The Erosion of “Public” Airports

Economic and Social Sustainability at Airports

ACRP Insight Event: Washington DC

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Economic and Social Sustainability at Airports

Developments may alter the social vs. commercial calculus of many airports

- **Growth in service, upgauging of aircraft and concentration into gateways**
 - Passenger growth accommodated in proportionately fewer operations
 - Airport terminals under pressure with gates, holdrooms, concessions
 - Airport ground transportation at breaking point during peaks at many airports
- **Gridlock in Washington and trouble with local politics:**
 - FAA bill may be of little assistance to authorizing funding for larger airports—management constrained by current regulations and policy culture
 - Service levels for CBP and TSA may be under continuing strain
 - Airport governance at local level under challenge given attractiveness of assets
- **Public airport model eroding, gradually replaced by commercial or airline model**
 - Historic public model of U.S. airports under severe pressure
 - Private equity views airport infrastructure as attractive, airlines see ability to capture control of scarce real estate and exert control
 - Indirect (public) vs. direct (private) benefits of airports at issue—goes directly to social sustainability mission

The Airport Industry's 2018 SWOT

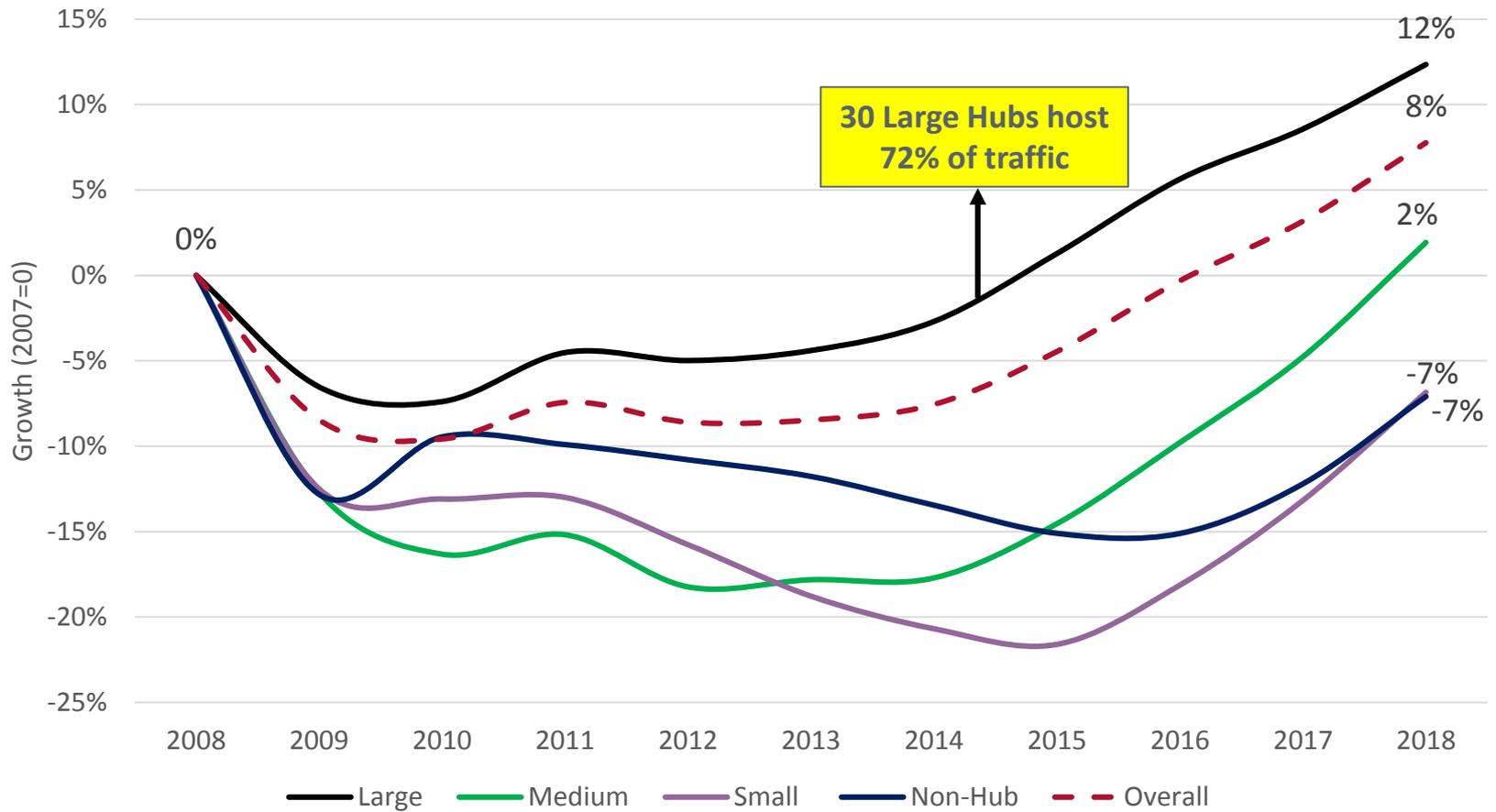
<p style="text-align: center;"><u>Strengths</u></p> <ul style="list-style-type: none">• Airport gateways and large hubs• Growth of domestic and international LCC/ULCC offers and competition• Liberalization / global traffic diversification• Airports' economic performance• Dollar easing for inbound travelers (not as good for us!)• Low fuel prices (but creeping up)	<p style="text-align: center;"><u>Opportunities</u></p> <ul style="list-style-type: none">• Longer haul, fuel-efficient aircraft driving new domestic & international routes to airports• Smartphones, payment apps, and E-Commerce enabling airports to deepen relationship with customers, improve the passenger experience and raise revenues• Ground transportation including TNCs and Connected Automated Vehicles (CAVs) offering new options and efficiencies• Private equity thirsting for airport investments
<p style="text-align: center;"><u>Weaknesses</u></p> <ul style="list-style-type: none">• Inability to directly charge passengers for use of infrastructure (AHT and PFCs)• Regulatory constraints on using commercial principles (e.g., pricing, leases)• Diversion of security and facilitation revenues (Trump Budget recommends increasing diversion)• Airports' vulnerability to airline market power• Policy gridlock• Lack of fuel-efficient aircraft < 90 seats	<p style="text-align: center;"><u>Threats</u></p> <ul style="list-style-type: none">• Increase in interest rates• Increase in fuel prices• Reversal of trend of air service liberalization• Increase in unfunded mandates for security, facilitation• Further airline consolidation (especially if JetBlue or Alaska is acquired)• Airside and terminal congestion management policies may not prioritize airport interests

The State of the Industry 2018

- Continued economic and aviation growth
- Airline profitability
- New entrants driving competition in many markets
- Service pressures on many airport facilities
- Limited federal help--airlines and equity filling the void?
- Protectionism, fuel price and interest rate headwinds

Is the model sustainable?

Airport Seats by Hub Size Compared to 2008 (Jan-Jul 2008-2018)

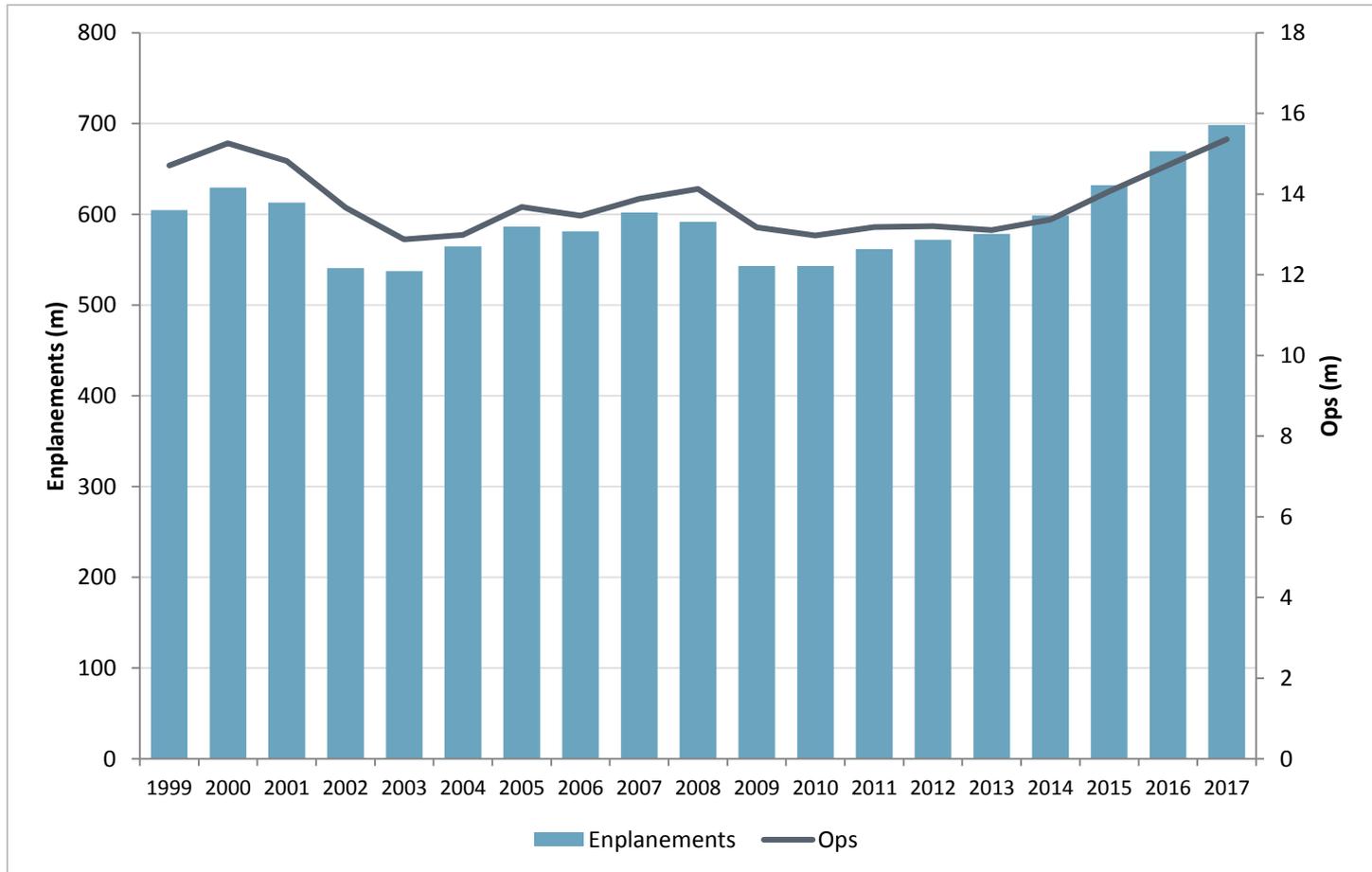


Source: OAG, January -July 2018 base, Steer Davies Gleave analysis

FAA Update: Enplanements vs. ATC Operations (1999-2017)

Enplanement growth hitting terminals and ground transportation

Enplanements up **15.5%**, Operations up 4.1%



Boston Logan and Capacity Challenges



Top-Line Economic Airport Issues

- **Top Airports:** Gateway and large O&D airports share problems with terminal space (i.e., gates, size of holdrooms, space for concessions) and ground transportation (i.e., gateways, roadways, curbs). *The days of “30 miles of runway” to relieve congestion are mostly over.*
- **Costs:** Passenger revenues come in linearly, costs come exponentially (e.g., constrained airport footprints). *Balancing investment risk (spending too much) and service risk (poor customer service) getting even more challenging.*
- **Lack of Independent Funding Source:** Lack of a PFC increase encouraging PPPs with private equity or airlines by encouraging airports to enter into long-term airline agreements. *Hoping for PFCs is not a strategy.*
- **Slots/Airside Congestion:** Growing congestion at gateway hubs. Who is going to allocate capacity at Level 3 (or slot controlled airports). IATA WSG, FAA, airports? Who captures the value or scarcity rent? *Fight underway in Europe; airports need an industry position.*
- **Commercial vs. Public Use:** New private equity players calling into question airport “over-built” infrastructure for users who don’t adequately contribute to the upkeep of the infrastructure and/or foreclose better use. *Business models being stressed...*

Airport Master Plans with Ground Transportation Strategies: *“Rip ‘Em Up”*

- **Ground transportation** continues to change, today representing the most common, unmet congestion problem for many airports
- **Roadways, transit and rail tracks/stations, rental car centers and parking** take up huge amount of land—what of is really necessary going forward?
Is this risk/reward what it used to be? What do we know and what don't we know?
- **Off-airport intermodal connections are highly regulated** by U.S. DOT/FAA (there is “pending” guidance). There is also little ability to pay for ground transportation with anything but non-aeronautical revenues, or as wrapped into PPPs.
- **“All you can eat” roadways and curbs by users (especially TNCs) and PUDO, not possible.** Solutions required (garage pickup, 2 seat rides required, fees).
- **Connected Automated Vehicles** offer new possibilities for on-airport movements—more flexible and scalable than traditional solutions (e.g., APMs).
- **Remote Terminals** on- and off-airports may be required. Can we figure out how to bring passengers directly airside?

Transportation Network Companies (SFO and BOS) Disruption to Airport Ground Transportation Planning

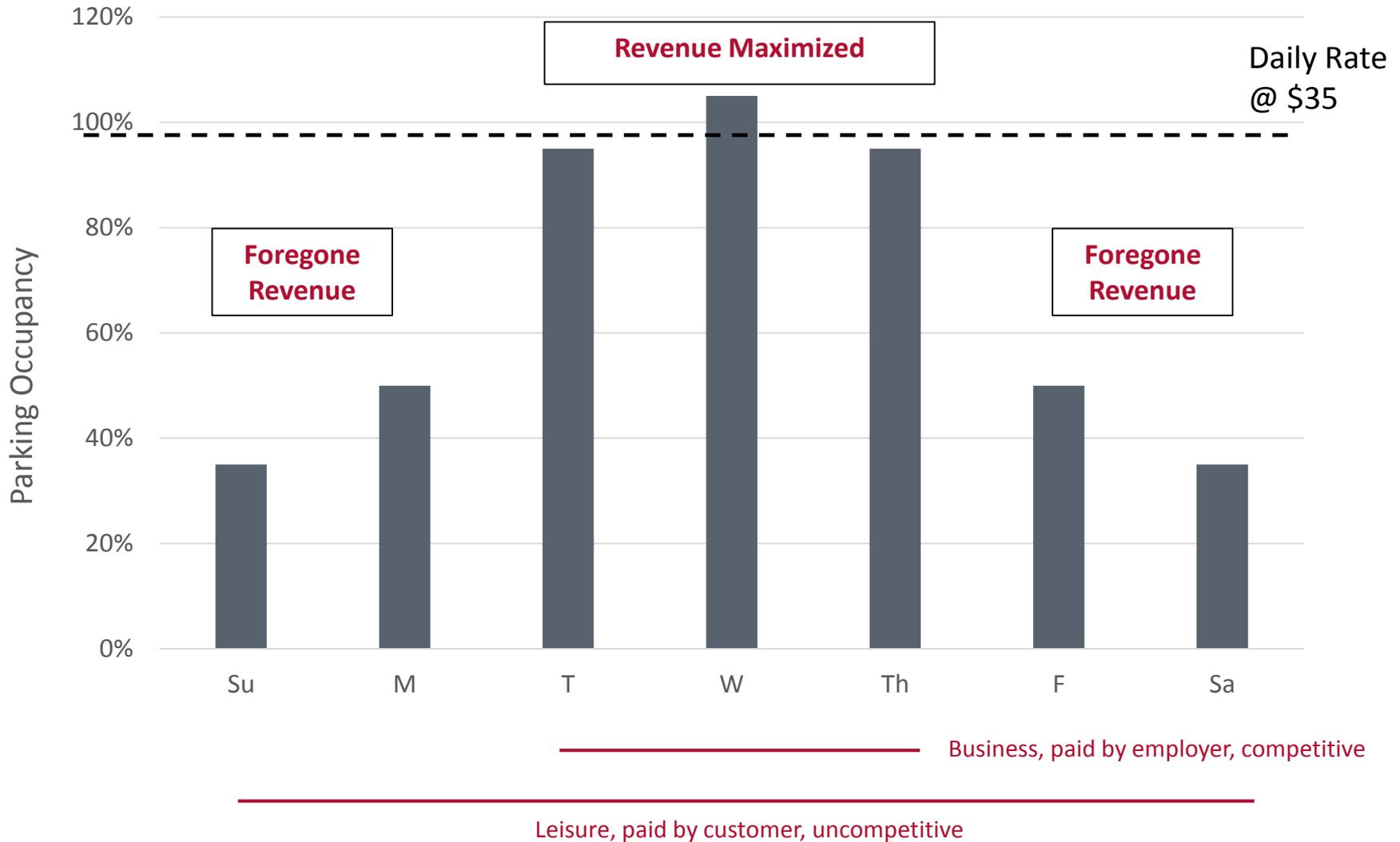
	SFO	BOS
TNC Agreement	Oct. 2014	Feb. 2017
Total Pax	55.8 million	38.4 million
Access Fee	\$3.80 pick up and drop off	\$3.25 pick up
Peak Month	692k	543k
Mode Share	34%	25%

TNCs provide door-to-door service for passengers, creating a demand responsive, affordable way to access the airport. While positive for customer service, the addition in single passenger vehicles is stressing airport gateways, roadways and curbs. The externalities are significant.

Commercial Revenues and Parking: Fight Back!

- **Daily pricing part of a supply-centric era** in which there was lower competition for the airport access market (e.g., no TNCs) and vehicle miles traveled was steadily increasing. Airports responded to the market by building additional lots to accommodate demand.
- **Customer have more choices today** and airports must provide ground transportation services and price access/parking in way to attract customers. Airports must also sort demand by day/time to improve utilization of their infrastructure in the shoulder and off-peak times.
- **Daily prices of \$35, for example, are only competitive for short-stay trips** typically at peak (Tu-Th), while the price would normally uncompetitive for the shoulders (M/F) and especially for off-peak.
- **Pricing by transaction** looks at total revenue generated by the trip and discounts those times that are underutilized and, even at peak, if it results in incremental revenue for the airport (and additional market share). At airports with transaction pricing, average stays increase from 2-3 days to 4-5 days.
- **The result is increased revenue and improved utilization**, potentially obviating the need for additional capital expenditures and/or reducing the size of parking projects (especially if combined with new products such as long-term valet).

Discount Pricing Premise: Daily Rate vs. Utilization



Public and Commercial Approaches to Today's Airport Market

Public Sector Challenges

- Inadequate airport terminal and ground transport infrastructure given airline trends of larger aircraft, higher load factors and reduced operations
- Traditional tools, such as AIP and PFCs, have lost real value since their peak 15-20 years ago
- FAA eligibilities prioritize airport airside needs over terminal and ground projects
- Airlines increasingly strong negotiators who are not reticent about wielding influence with airport boards and in Washington. Their offer to build needed airport capacity comes at a price

Commercial Drivers

- The Airport sector is attractive due to its market (reliable growth), development opportunities and cost-recovery mechanisms
- Experience with overseas airports has established a solid track record with EBIDTA multiples averaging around 12x (and even higher for immature markets)
- Different airport challenges, provide the right fit for equity investors with varying risk/return expectations
- Privatization redefined as PPPs for vast majority of U.S. airports and projects
- Recent track record of USA airport PPPs proves you CAN do it, stimulating interest

Considerations for U.S. airports on Privatization/PPPs

- 1. Goals of investor:** expectation of profit, role the airport would play in their investment portfolio
- 2. Value drivers:** where will the investor create value (revenues and expenses)?
- 3. Public vs. private:** public airports use commercial means and cost-recovery to meet *public ends*—private investors use commercial means for *private ends*—to make a profit and return value to shareholders
- 4. Constituency vs. shareholders:** Public airport leadership principally concerned for the *indirect benefits* provided to community (e.g., visitors, tax base, gateway), while private airport leadership concerned about the *direct benefits* (e.g., maximizing revenues and minimizing costs which lead to profitable performance)
- 5. Investors views of U.S. airports:** Infrastructure-rich due to AIP – excess airside infrastructure, creates inflated operations and maintenance requirements; commercial offer not fully exploited (e.g., parking, food and beverage); headcounts for airport staffs high. Optimization may require staff reductions, contracting out and replacement with technology where possible (they are learning that is not as easy as it sounds)

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