ACI-NA Business Term Survey
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Airport/Airline Business Working Group

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Agenda

- Background
- Rates and Charges
  - Methodology Overview
  - Operating Expenses
  - Capital Costs
  - Rate Details
  - Common Use Fees
- Other Contents
  - Capital Review
  - Preferential Gate
  - Miscellaneous

The ACI-NA business term survey is becoming one of the most valuable sources of airport ratemaking.

- History
  - Since 2003, ACI-NA has conducted several business term surveys regarding airline use agreements.
  - Key contents covered in the surveys include rates and charges, capital review and facility control.
- Purpose
  - Build a comprehensive database for airport method and practice when negotiating airline use agreements.
  - Encourage knowledge transfer among colleagues.
  - Identify a package deal reached at a given airport.
- Since 2015, Professor Jonathan Williams has assisted ACI-NA in building a web-based survey that provides a convenient interface for responding and generating outputs.

ACI-NA received 60 responses and will continue working with the remaining airports.

- In 2016, the airport/airline business working group in ACI-NA, led by Randy Bush from CMH, revised the business term survey to provide consistent definitions and to improve accuracy and usefulness.
- ***If you have not responded to the survey, please send your airline agreement to us; we will help populate the responses!***

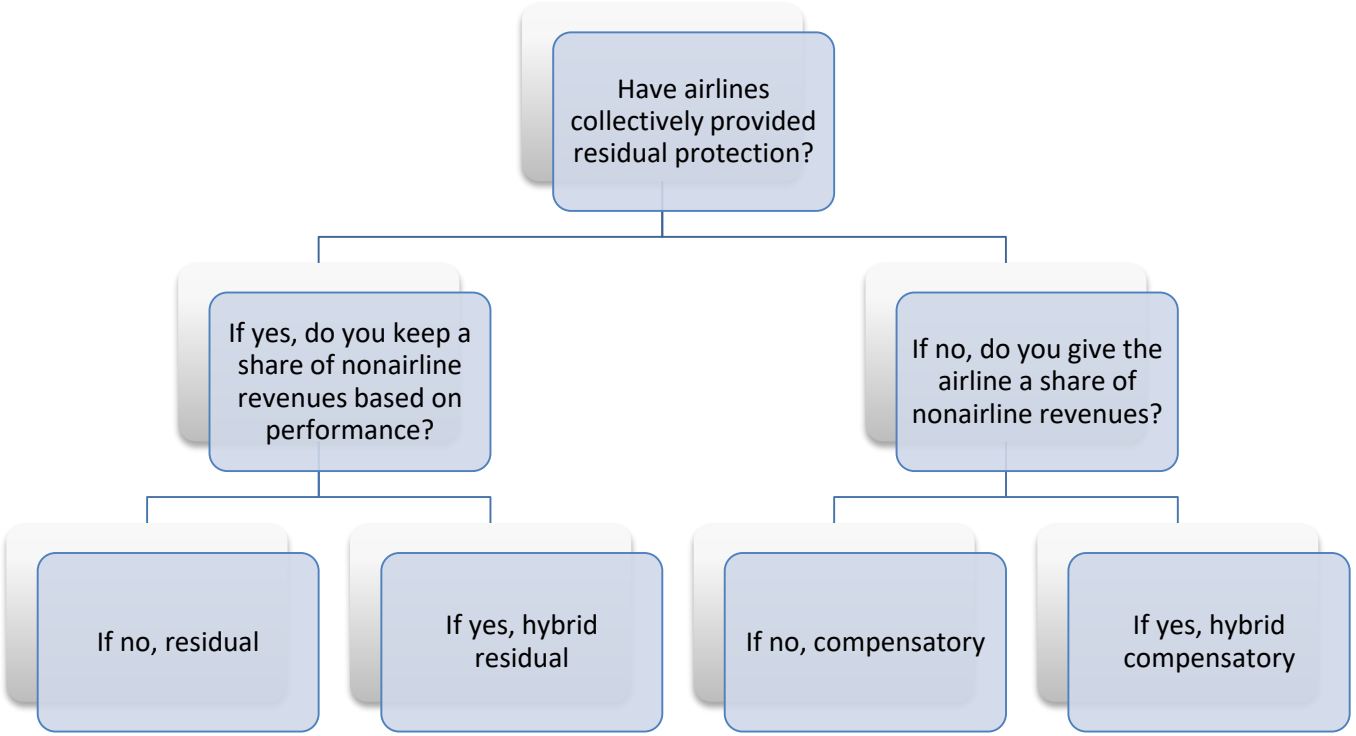
FAA 2015 hub category	Complete or partially complete	Number of airports	% responded	Missing information
Large	26	30	87%	None, need airport approvals
Medium	17	30	57%	3 known; missing 10
Small	17	71	24%	Mostly unknown
Total	60			

Rates and Charges

There is some confusion regarding the rates and charges methodology.

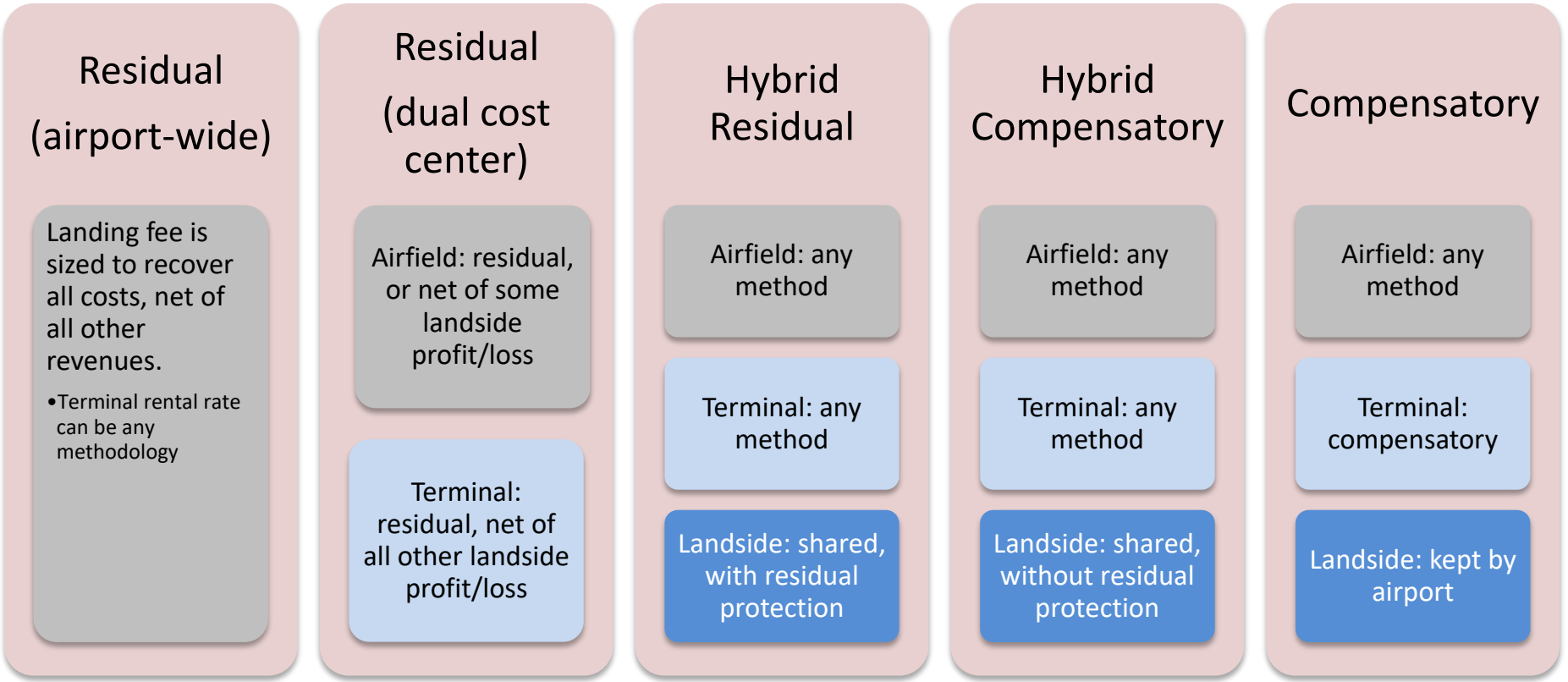
- Traditionally, there are only two rate methodologies:
  - Residual: airlines agree to pay any costs of running the airport that are not allocated to other users.
  - Compensatory: the airport operator assumes the major financial risk of running the airport and charges the airlines only for their fair share of costs (instead of whatever is necessary to break even).
- A third category – hybrid – was created in the most recent decade, which leads to confusion.
- The working group has further split hybrid between hybrid residual and hybrid compensatory.

Residual protection and revenue sharing are two key issues to determine rate methodology.



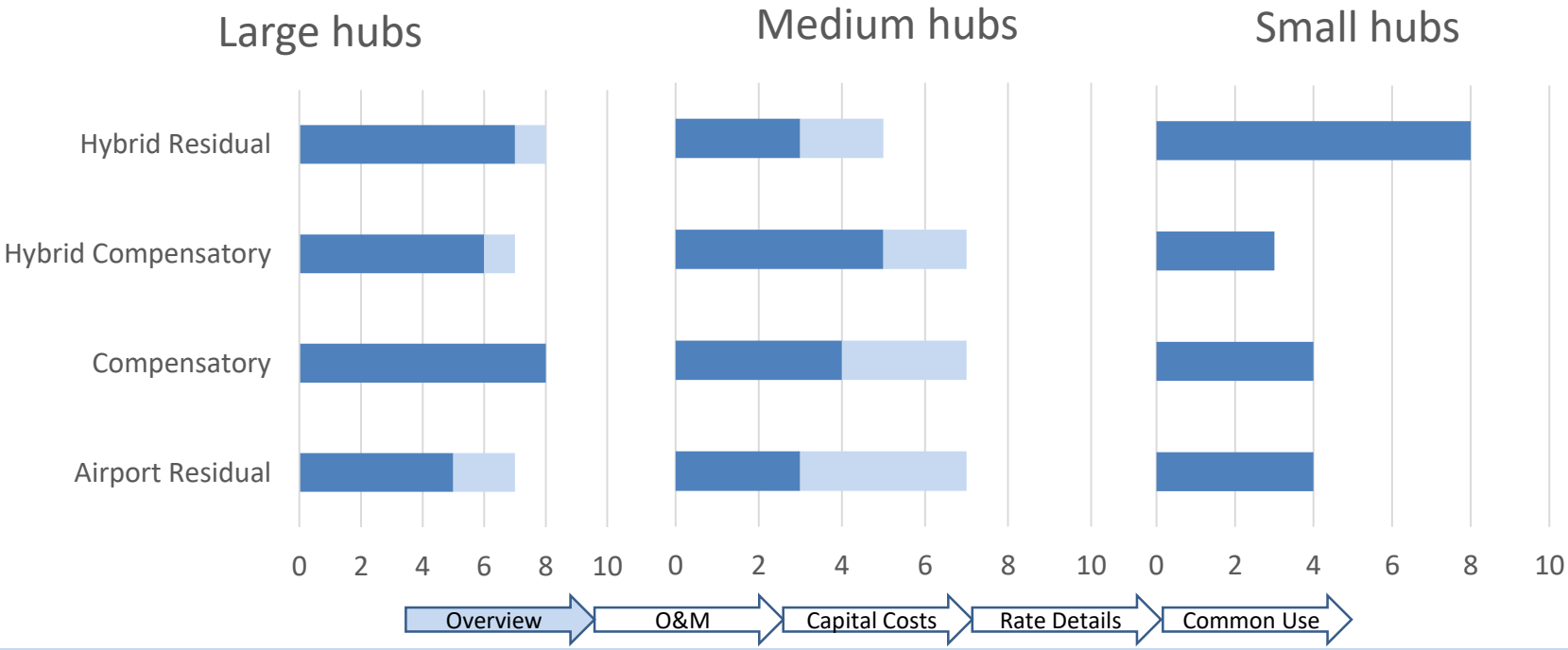
- Materiality
  - A residual airport can have a small cost center not guaranteed by airlines.
  - A residual airport can keep a small portion of nonairline revenues (e.g., profit/loss from cargo cost center) and still be called residual instead of hybrid.

Airport-wide ratemaking may not be the same as the cost center ratemaking methodology.



Residual/hybrid residual and compensatory/hybrid accounted for roughly 50% each.

- 3 large hubs and 3 medium hubs reported rate-setting under unilateral resolutions; another large hub with rate resolution has not responded.
- 15 large-hub airports (50%) reported residual or hybrid residual.
- 12 medium-hub airports (less than half) reported residual/hybrid residual.



Surprisingly, long-term agreement is still popular among large hubs, likely due to capital program.

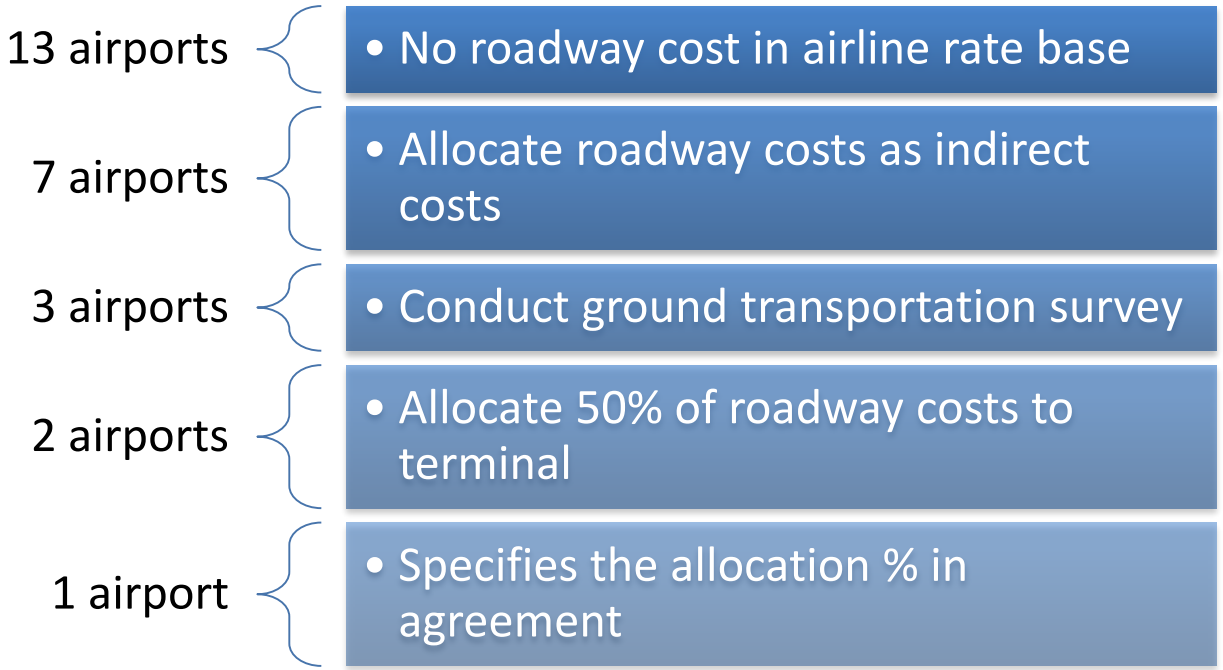
Less than 5	5-7 years	10 years	> 10 years
• Rate by resolution airports (BOS and PHX) • Rate agreement (MCO) • Auto-renew (HNL)	• BWI • DEN (WN) • PHL • SAN • SEA	• CLT, DCA, DFW, IAD, LAS, LAX (rate agreement), PDX, SFO, SLC, TPA (extended)	• DTW, FLL (extended), IAH, MDW, MIA, MSP, ORD, PANYNJ airports

Administrative expenses are typically allocated based on direct expenses.

- A majority of the respondents (55 out of 57) reported that they include some kind of operating expense allocation procedure in the airline agreement.
  - This ranges from a simple statement such as “Indirect expenses shall be allocated according to the distribution of direct expenses” to very detailed exhibits showing the allocation ratios of each function.
  - Note: A different number of airports responded to each question.
- 32 out of 56 respondents reported that they allocate administrative expenses according to direct expenses, and another 16 responded that they allocate administrative expenses based on management estimates.
  - 5 airports included operating revenues as one factor to allocate administrative expenses.
  - 3 others have not specified.

Allocation of roadway costs is a key issue in compensatory rate-making.

- Roadway costs can be further separated among airside roadways, terminal roadways (within terminal curbside) and other access roads
- Of 26 airports reporting compensatory or hybrid comp. ratemaking:

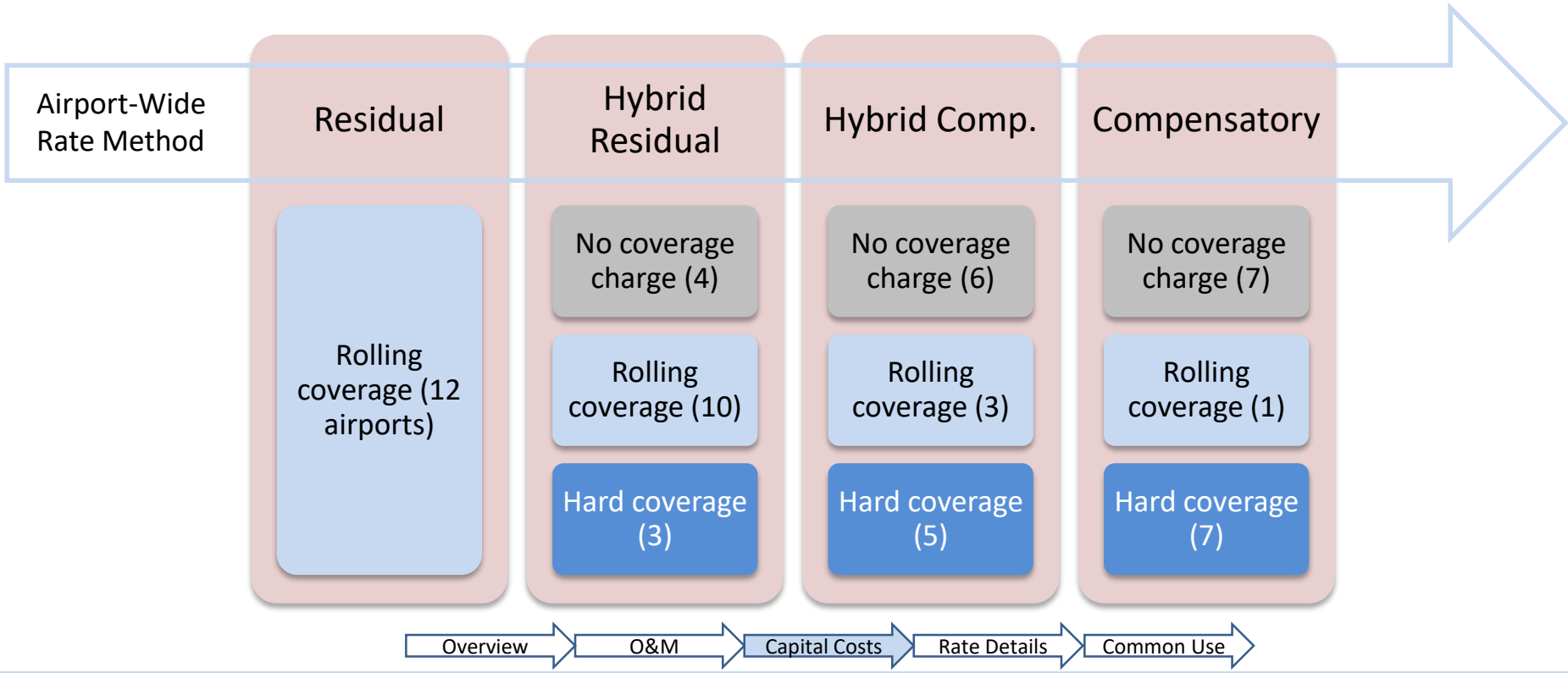


Debt service or internal cash spent on capital projects could be included in airline rate base.

- About 75% of respondents reported that they allocate debt service to airline cost centers to recover debt service instead of using depreciation/amortization for bond-funded assets.
  - Upon further review, it is estimated that at least 24 large-hub airports are using this approach.
- 63 airports responded to the question of how they recover internal cash used to fund capital projects, which must be further reviewed.
  - 11 airports reported that they do not recover such cash.
  - Of the remaining 52 airports, they amortize the cash spending using:
    - Average borrowing rate (9 airports)
    - Projected borrowing rate (7 airports)
    - Fixed rates (7 airports)
    - Certain index, ranging from the Bond Buyer Index to treasury rate (7 airports)
    - Other airports have not specified

Debt service coverage requirement is typically funded by rolling coverage.

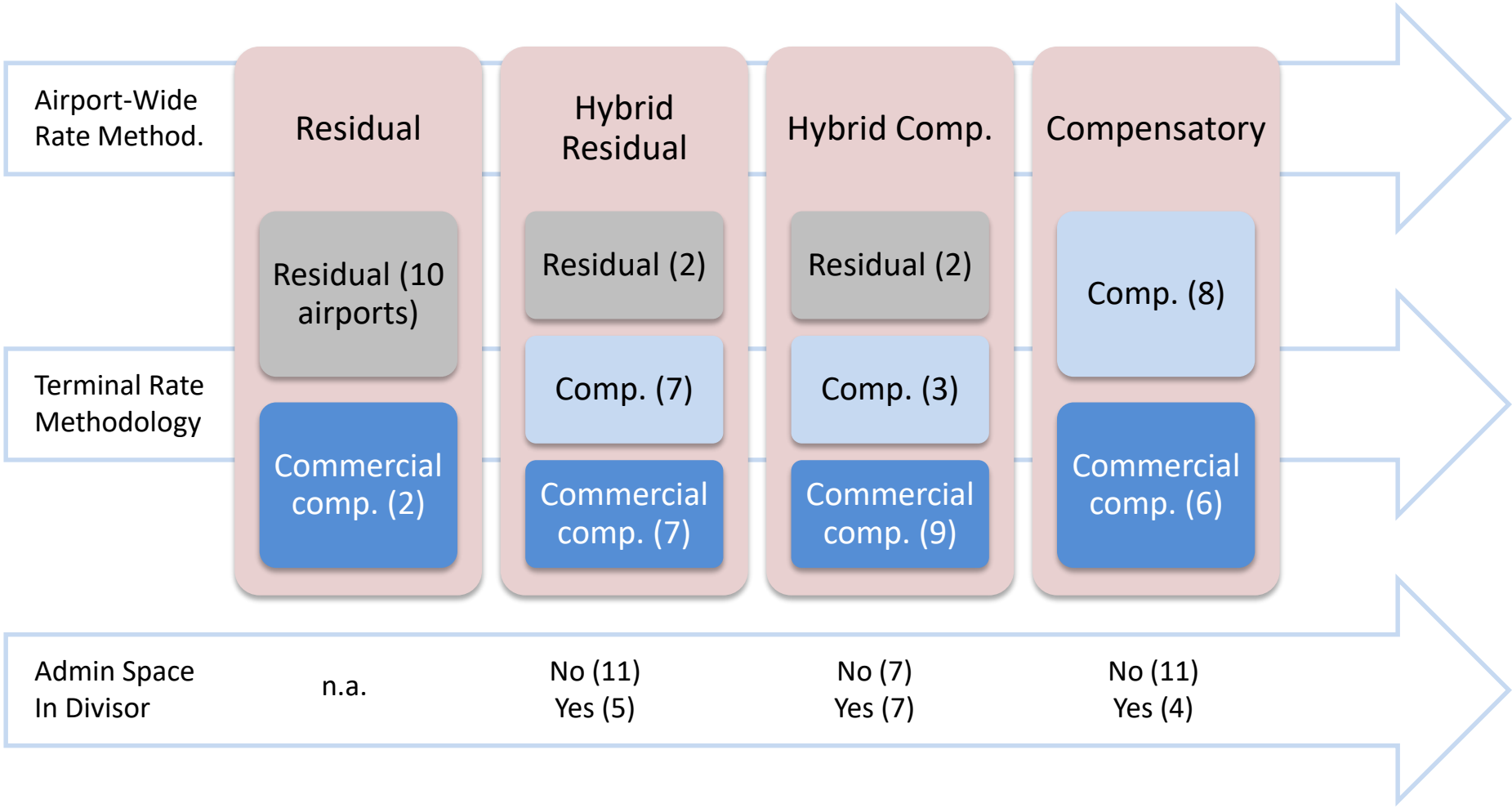
- The bond document typically requires two tests: a flow test to ensure adequate cash flow, and a coverage test to preserve a safety margin.
- Of 58 airports that responded:



Residual landing fee methodology is the norm.

- Although an airport cannot impose airport-wide residual ratemaking on airlines, the landing fee rate can be calculated using an approach similar to residual:
  - Aggregate of airfield-related direct and indirect operating expenses, debt service, and fund deposit
  - Net of general aviation-related fuel flowage fee and other revenues
  - Divided by the sum of signatory and non-signatory airline landed weight
- Comparatively, a compensatory landing fee is calculated by dividing the net requirement by the total landed weight (commercial airlines plus general aviation and other activities).
- More than half of airports reported a 25% premium on nonsignatory airlines, with 2 airports reporting a 50% premium under airline agreement.

More airports are using a compensatory or commercial compensatory for terminal ratemaking.



Airports tend to customize revenue sharing to fit their specific needs

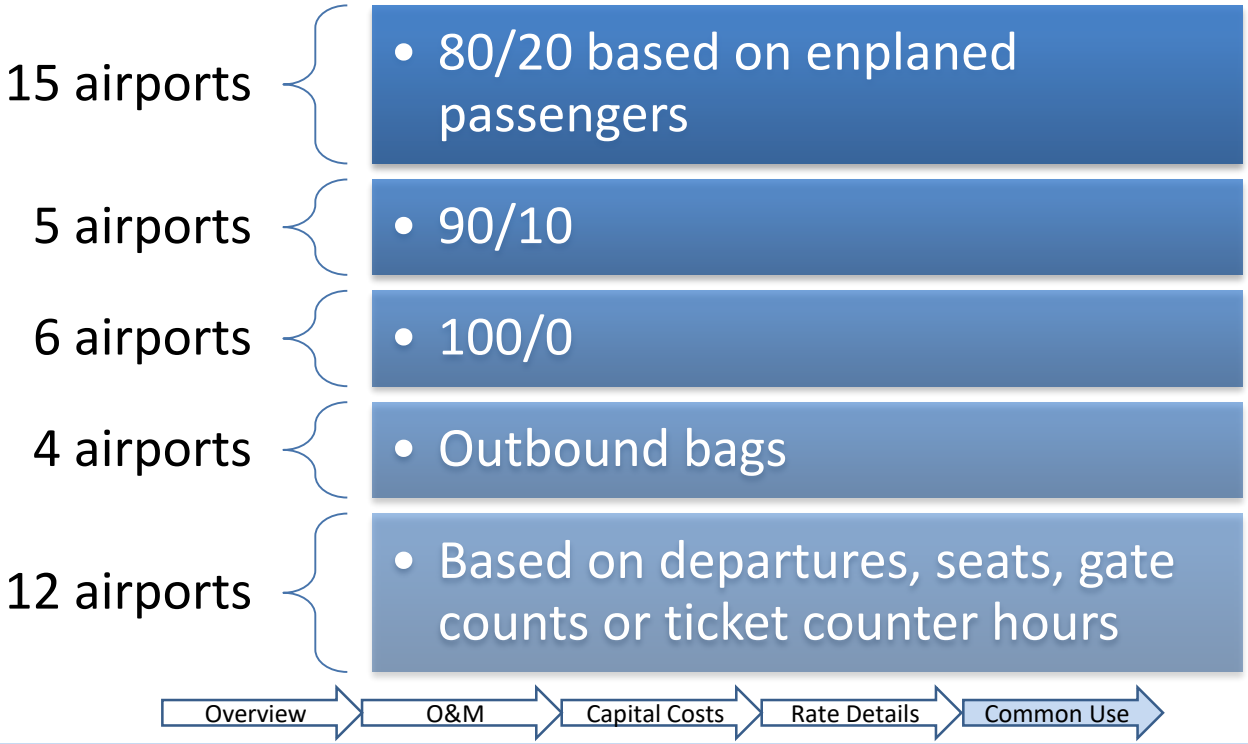
- Of hybrid residual and hybrid compensatory airports, 21 airports reported revenue sharing, with many variations.
  - 10 airports tie revenue sharing with net remaining revenues.
    - 4 airports share a fixed % of net remaining revenues.
    - 6 airports share a variable % of net remaining revenues, and/or subject to a floor amount or a ceiling amount.
  - 6 airports share certain types of concession revenues or a share of certain types, such as rental car or terminal concession revenues.
  - 4 airports tie the sharing amount to enplaned passengers or incremental enplaned passengers.
  - At least 1 airport ties the sharing amount to debt service coverage.

More airports are using 90/10 or 100/0 formula to allocate baggage claim expenses

- Historically, 80/20 has been the standard formula allocating baggage claim expenses.
  - 80% based on enplaned or deplaned passengers
  - 20% based on the number of users
- In this survey, 12 airports reported 100/0 (no fixed fee portion), 7 reported 90/10, and 17 reported 80/20.
  - Some airports exclude low-volume carriers from the allocation of the fixed fee portion.
  - 6 airports allocate baggage claim costs based on bags.
  - 8 airports allocate baggage claim costs on other methods, such as seats, turns or space.

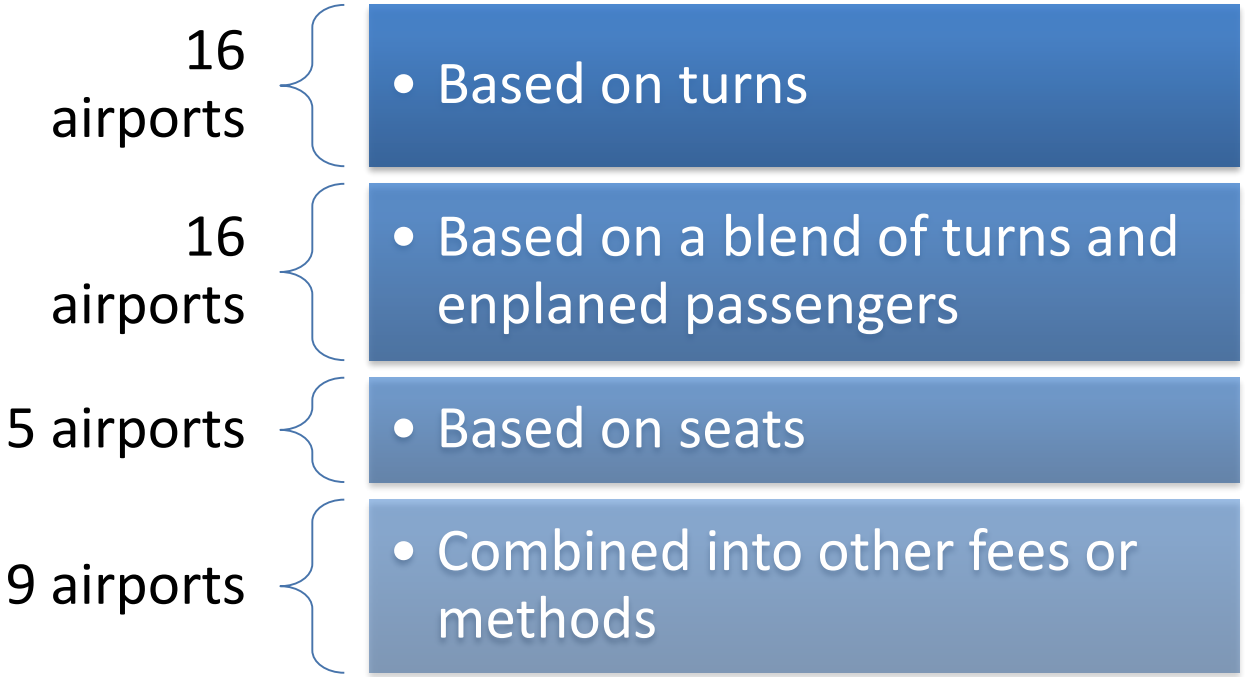
Baggage makeup space is not necessarily available on a common use basis.

- Many airports have common use baggage makeup of some kind, but more than 25% of airports reported that they do not offer baggage makeup on a common use basis.
- Among 42 airports with common use baggage makeup space:



Holdroom cost allocations tend to include turns as a factor.

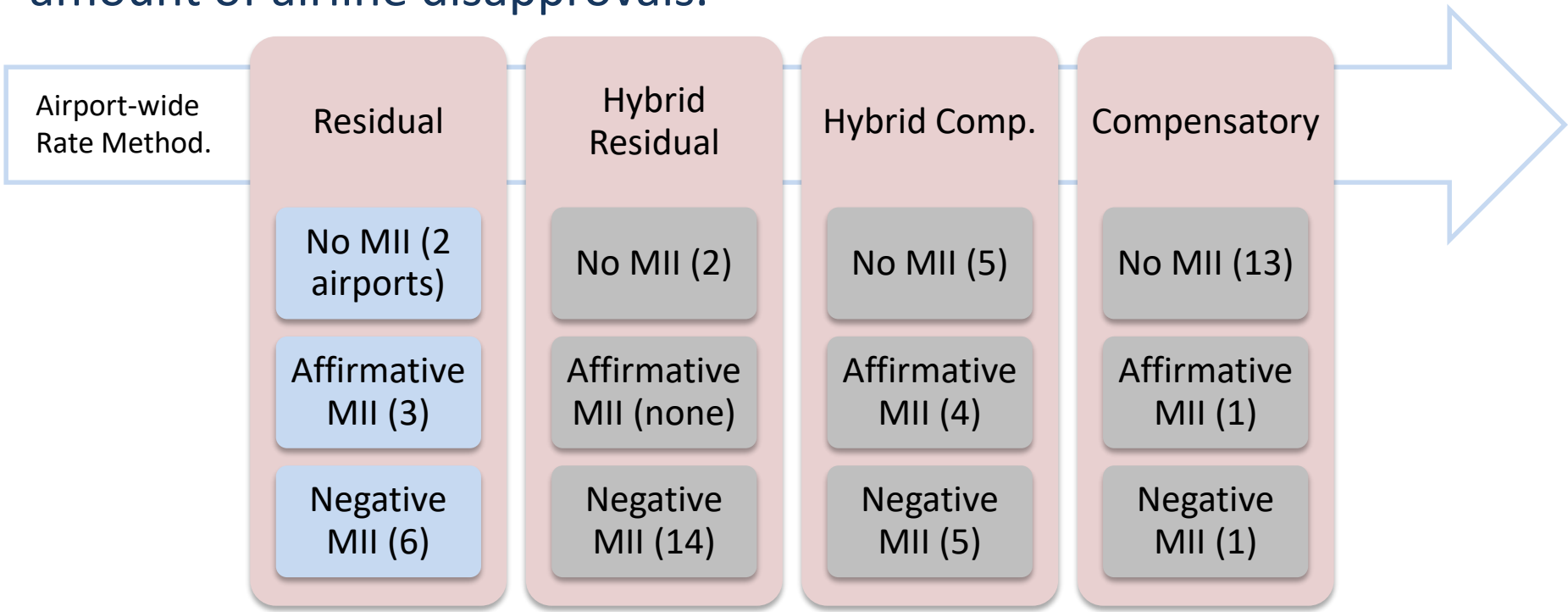
- 25% of airports reported that they do not offer common use holdrooms.
- Among 46 airports with common use holdroom space:



Other Contents

The capital review process is closely tied to ratemaking methodologies.

- Affirmative MII: an airport cannot proceed unless it receives enough airline approvals.
- Negative MII: an airport can proceed unless it receives a certain amount of airline disapprovals.



The capital review process is also influenced by known capital needs.

- Other issues to consider in the capital review process:
  - Exempted projects
  - Pre-approved CIP
  - Annual allowance or deposits to maintenance reserve
  - Small capital outlay or equipment purchase
  - Separate MIIs for airfield vs. terminal (how about one for int'l arriving building/FIS?)
- One-third of airports reported that they cannot proceed with a project if airlines rejected it twice under the negative MII.
  - For the remaining two-thirds, one phrase is recommended to add: "Airport can proceed with the proposed capital projects after a delay of <<>> months, ***and include the related operating expenses and capital costs in the calculation of airline rates and charges.***"

There is a wide range of qualification criteria for preferential gates.

- Of 61 airports responding, 39 have not set a threshold.
- Of the remaining 22 airports:
  - 13 airports selected 4-7 daily turns as the criteria, with 6 turns being the most popular (5 airports).
  - 5 airports selected seats as the criteria, ranging from 500 seats to more than 1,000 seats, tied to airport overall utilizations.
  - One airport allocates gates based on the August seat schedule.
  - 3 other airports have not specified their methods.
- Some issues to consider:
  - Should the threshold be dynamically tied to seats or turns?
  - Should there be an initial threshold and a maintenance threshold, similar to equity investment?
  - Should the common use fee for an airline be capped if they qualify but can't get a gate?

Next Steps

Data quality remains an issue, and more responses are needed.

- The airport/airline business working group has reviewed a portion of the responses and attempted to contact the airports to revise some answers.
  - We have found minor issues in almost all responses we reviewed, mostly due to inconsistent definitions.
- This can be a good learning opportunity for your staff. Please email dwu@dwuconsulting.com if:
  - You are not certain whether your airport has responded to the survey, or
  - Your staff wants to learn more about the survey questions.

Thanks to everyone who has assisted with this survey!