



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: John Aitken

SUBJECT: PROPOSED AIR SERVICE
SUPPORT PROGRAM REVISIONS

DATE: September 12, 2018

Approved

D. D. S. L.

Date

9/14/18

RECOMMENDATION

Adopt a resolution revising the airline support program to update and increase the North American marketing funds, reduce fee waivers to reflect current constraints on airport facilities, and authorize the Director of Aviation to extend the program benefits and award marketing funds in cases where an airline introduces multiple low frequency services within a 12 month period, and repealing Resolution No. 77634.

OUTCOME

Over the past four years, Norman Y. Mineta San José International Airport (SJC) has seen a 50% increase in flights and passengers and has outpaced the nation's major airports in growth. Despite this impressive record that includes the introduction of many new nonstop domestic and international destinations and seven new airlines to SJC, the industry continues to be extremely competitive and is now witnessing significant financial impacts directly related to rising fuel prices. Air service remains a very costly business investment, as demonstrated by widespread airline announcements of reductions in growth and billions of dollars in additional fuel costs.

Given these conditions, it is recommended that modifications be made to the support program that will update the amounts of marketing funds to support new domestic long-haul and North American service, limit the period of landing fee waivers to a maximum of 18 months, eliminate all waivers of ticket counter and gate fees, eliminate additional marketing funds above the standard qualified levels for new entrant airlines, and provide discretion for the Director to extend the program and award limited marketing funds to support a combination of new low frequency routes by the same carrier.

Authorizing these changes, last updated by Council in December 2015, will better reflect current conditions and keep important benefits of the program intact, while reducing exposure to substantial ticket counter and boarding gate fee waivers during a time when SJC is having to invest in expanded facilities.

EXECUTIVE SUMMARY

Air service incentive and support programs are widespread in their use by U.S. and foreign airports, and have become so common as to be expected by many airlines seeking to launch new service. Acknowledging the substantial investment in aircraft, pilots, crews, fuel and other operating costs, personnel, and airport fees, the SJC support program helps dedicate specific marketing funds to promote new routes and waive a portion of airport fees to help offset start-up costs.

In 2015, City Council authorized changes to SJC's program to increase marketing support for long haul international routes, recognizing the very high costs of launching trans-oceanic flights and the extremely competitive landscape between candidate cities to obtain such high profile services. However, marketing funds for domestic and North American routes were not changed at that time, and have not been altered in many years. Fee waivers, applying to landing fees, ticket counters, and boarding gates, have also remained unchanged to date.

The recommended changes will make domestic and North American marketing funds more impactful for the promotion of qualifying routes, reduce fee waivers (thus increasing revenue to the airport) at a time when SJC is experiencing facility constraints, and allow the flexibility to extend the program and award marketing support, subject to limits and City appropriation of funds, to an airline that begins multiple low frequency service within a 12 month period. New entrant airlines will qualify for the same landing fee waivers and dedicated marketing funds as incumbent carriers, but will no longer qualify for facility fee waivers.

BACKGROUND

The Airport is a strategic asset for achieving the City's economic development goals. Air service provides an essential link to support and sustain Silicon Valley's quality of life by moving people and products between San José and both domestic and global destinations. Gaining better access to national and international markets and technology centers has long been a priority of the region's businesses. Community and business leaders and travelers have clearly expressed a strong desire for improved access between San José and key domestic and international cities.

Following the dramatic increases in oil prices in 2008 and the impact of the global recession, airline consolidation accelerated and the industry as a whole reduced flight and seat capacity to improve profitability. This essentially eliminated short-term growth within the industry. Since 2008, the newly consolidated mega-carriers also systematically shifted flights in multi-airport regions to the large, international hubs including San Francisco, Los Angeles, and Boston. Medium-size airports, including SJC, witnessed substantial reductions in service at that time and the Air Service Support Program has contributed to attracting the service we have today.

From the program’s beginning in 2006, the SJC Air Service Support Program has continued to evolve to acknowledge changes in the industry as well as competitive dynamics. Airports similar in size and route network breadth to SJC also have fee waivers and marketing funds available for airlines serving both domestic and international destinations. However, SJC is also competing in a larger arena with much bigger markets as well as aggressive initiatives and/or outright stakeholder-backed subsidies, and must remain competitive in the pursuit of new airlines and nonstop routes.

ANALYSIS

Current Air Service Support Program

The terms of the current Air Service Support Program are outlined in the summary table below. Additional details regarding each section follow the summary table:

Service	Landing Fee Waiver	Ticket Counter/ Gate Fees Waiver	Marketing Funds
New Short-Haul Domestic*	100% for 12 Months	n/a	Up to \$25,000
New or Added Long-Haul Domestic	100% for 18 Months	n/a	Up to \$50,000
New International Within North America	100% for 18 Months	n/a	Up to \$50,000
New International Outside North America	100% for First 18 Months, 50% for Next 12 Months	n/a	Up to \$500,000
New Entrant Carrier	As Above	Same Duration as Landing Fee Waiver	As Above + Up to \$100,000

Airlines need to apply for the support program and work with SJC staff to coordinate fee waivers and marketing funds; details of each category of qualifying service are described below:

Short-Haul Domestic Destinations

- Short-haul domestic destination defined as within 1,250 mile radius of SJC
- 100% waiver of landing fees for up to 12 months for new destinations

Long-Haul Domestic Destinations

- Long-haul domestic destination defined as more than 1,250 miles from SJC

- 100% waiver of landing fees for up to 18 months for new destinations even if currently served by another carrier or for any added frequency if currently served by the carrier that is adding service

International Destinations within North America

- 100% waiver of landing fees for up to 18 months for new destinations

International Destinations Outside North America

- 100% waiver of landing fees for the first 18 months of service, 50% waiver for the next 12 months for new destinations
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International Seasonal Service

- Seasonal schedule must be declared at the start of service
- 100% waiver of landing fees for the duration of the first year of seasonal service
- If seasonal service returns as year-round service, the start date of the full support program will coincide with the launch of the first seasonal service

New Entrant Carrier

- In addition to landing fee waivers, 100% waiver of Eligible Terminal Rents (ticket counter and gate fees), excluding Baggage Claim Charges, Baggage Make-Up Charges, and Exclusive Use Premises Charges, for 12 months for any new U.S. short-haul destinations; 18 months for any U.S. long-haul destination
- In addition to landing fee waivers, 100% waiver of Eligible Terminal Rents for 18 months for new international destinations within North America
- In addition to landing fee waivers, 100% waiver of all Eligible Terminal Rents for 18 months and 50% waiver for the next 12 months for new international destinations outside North America

Marketing Funds

- Marketing Introduction Program available to all new destinations – such resources may include on-airport messaging, website announcement, external newsletter announcement, public relations assistance, and community/business introductions
- Up to an additional \$25,000 in marketing funds for new short-haul U.S. destinations without airline match requirement
- Up to an additional \$50,000 marketing funds for any new or additional frequencies to long-haul U.S. domestic destinations without airline match requirement
- Up to an additional \$50,000 marketing funds for new international destinations within North America without airline match requirement

- Up to \$500,000 funds for any new international destination outside of North America to be spent within the first two years of operation (pro-rated for seasonal service) without airline match requirement
- Up to an additional \$100,000 funds for new entrant carrier without airline match requirement
- All marketing funds must be used to promote the specific route to SJC

Snap-back Invoicing Policy

- The Director of Aviation will have the authority in extenuating circumstances to remove “snap-back” invoicing of landing and terminal fees if service is cancelled within the minimum qualifying period (12 consecutive months or 4 consecutive months for international seasonal service).

Additional Frequency Policy

- The Director of Aviation will have the authority to determine application of support funds for additional frequencies on existing routes.

Minimum Flight Requirements

- Minimum requirements to be eligible for support program: Three (3) weekly round trips for 12 consecutive months or four (4) consecutive months for international seasonal service.

Proposed Revisions to the Current Air Service Support Program

The proposed revisions to the support program reflect airlines’ continued interests in stronger marketing to promote a new nonstop route. At the same time, the proposal is to reduce the fee waiver elements of the program given current constraints on airport terminal facilities. Therefore, Airport staff recommends that landing fee waivers be capped at 18 months’ duration for qualifying categories of service. For a new entrant carrier, staff recommends that the existing benefit of an additional \$100,000 maximum in marketing funds will be eliminated and there will be no facility fee waivers for ticket counters and boarding gates.

Staff recommends the following revisions to the current support program as outlined in the comparisons shown below.

Current Air Service Support Program

Service	Landing Fee Waiver	Ticket Counter/ Gate Fees Waiver	Marketing Funds
New Short-Haul Domestic*	100% for 12 Months	n/a	Up to \$25,000
New or Added Long-Haul Domestic	100% for 18 Months	n/a	Up to \$50,000
New International Within North America	100% for 18 Months	n/a	Up to \$50,000
New International Outside North America	100% for First 18 Months, 50% for Next 12 Months	n/a	Up to \$500,000
New Entrant Carrier	As Above	Same Duration as Landing Fee Waiver	As Above + Up to \$100,000

*Short-haul domestic destination within 1,250 mile radius of SJC.

Proposed Program

Service	Landing Fee Waiver	Marketing Funds
New Short-Haul Domestic*	100% for 12 Months	Up to \$25,000
New or Added Long-Haul Domestic	100% for 18 Months	Up to \$75,000
New International Within North America	100% for 18 Months	Up to \$100,000
New International Outside North America	100% for 18 Months	Up to \$500,000

*Short-haul domestic destination within 1,250 mile radius of SJC.

As previously described, in cases where an airline introduces multiple low frequency routes within a 12 month period, the Director of Aviation would also have the discretion to recognize the contribution of these additional services and extend the program benefits including landing fees by category and award marketing funds not to exceed \$100,000 and subject to City appropriation of funds.

EVALUATION AND FOLLOW-UP

Airport staff managing the Air Service Support Program will continue to monitor the number of flights to the specified destinations supported by the program to ensure that minimum service levels are met and adherence to the program specifications is maintained throughout the application period of the program. Fee waivers and marketing support in excess of \$100,000 for all qualifying routes will continue to be brought before Council as a public hearing and all fee waivers and marketing support will remain subject to appropriation of funds.

POLICY ALTERNATIVES

If Council does not approve revisions of this program, the current terms and conditions would continue. The proposed changes reflect the maturing of the support program and a willingness to respond to the needs of the airlines while recognizing the impact of terminal facilities constraints.

PUBLIC OUTREACH

This memorandum will be posted on both the Airport's website and on the City's Council Agenda website for the September 25, 2018 Council meeting.

COORDINATION

This memorandum was coordinated with the City Attorney's Office and the City Manager's Budget Office.

COMMISSION RECOMMENDATION/INPUT

This item does not have explicit input from the Airport Commission, although Commission members are provided with regular updates and discussion of all new airline services and any plans to modify the support program at each scheduled meeting and have expressed support of the Airport's Air Service Support Program.

FISCAL/POLICY ALIGNMENT

This project aligns with the City's Economic Development Strategy #9 "Keep Developing a Competitive, World Class Airport, and Attract New Air Service." Application of the Air Service Support Program to assist the air carriers in succeeding financially in serving the new destinations will benefit the City.

COST IMPLICATIONS

The air service support program will continue to result in marketing funds dedicated to the promotion of new flights and waivers of airline fees for qualifying service. However, even with increased marketing for domestic and North American routes, the combination of reduced fee waivers for airport facilities with higher revenue from concessions, car rentals, parking, Passenger Facility Charges, and other airport services that will directly result from increased air service is expected to continue offsetting the short-term loss of revenue from waived fees and marketing expenditures.

CEQA

Not a Project, File No. PP17-003, Agreements/Contracts (New or Amended) resulting in no physical changes to the environment.

/s/

JOHN AITKEN, A.A.E
Director of Aviation

For questions, please contact John Aitken, Director of Aviation at (408) 392-3610.