

Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: John Aitken

**SUBJECT: PUBLIC HEARING FOR AIR
SERVICE SUPPORT PROGRAM**

DATE: September 12, 2018

Approved

D. D. Syl

Date

9/14/18

RECOMMENDATION

- (a) Conduct a Public Hearing pursuant to California Government Code Section 53083 regarding application of the City's Air Service Support Program, as authorized by the Federal Aviation Administration to Delta, Volaris, and California Pacific Airlines.
- (b) Adopt a resolution authorizing the Director of Aviation or the Director's designee to provide the City's Air Service Support Program to new air carrier service as outlined in the table below:

Delta, Volaris, California Pacific Routes

Airline:	Delta	Volaris	Volaris	Volaris	CP Air
Market:	Detroit	Morelia	Zacatecas	Leon	Carlsbad
Airport	DTW	MLM	ZCL	BJX	CLD
Frequency	1 Daily	2/Week	2/Week	2/Week	2 Daily
Support Period	18 Months	18 Months	18 Months	18 Months	12 Months
Landing Fee Waivers	(\$174,521)	(\$49,592)	(\$46,962)	(\$49,592)	(\$56,204)
Marketing Funds	(\$75,000)	(\$33,333)	(\$33,333)	(\$33,333)	(\$25,000)

For each route, landing fees are waived under the program for the qualifying periods and/or marketing funds are provided to promote the new services.

OUTCOME

The Airport support program is envisioned to help airlines offset high initial risks and costs to start new service by waiving landing fees and/or providing marketing support where applicable. Making the support program available to these airlines will help them during the most difficult time of the new service launches from San José to their respective destinations. The result will be a higher tolerance for initial route startup risks by airlines, while increasing chances to gain long term maturity and associated profitability. The long-term success of these important new

routes will benefit the Airport as well as the City by increasing revenues for both entities and providing additional travel options for our community.

The table below shows the positive impact of the new routes on Airport finances. Airport support amounts, consisting of initial period fee waivers and/or marketing funds, are exceeded by other airport fees not subject to waivers and net airport revenues from concessions, parking, Passenger Facility Charges (PFCs), and other activities. The result is positive incremental revenue for the Airport for the duration of the support period applicable to each route.

Delta Air Lines has consistently expanded its presence at SJC over the past three years, now announcing service to its Detroit hub after recently launching new daily nonstop flights to New York's JFK International Airport. With the addition of Detroit (DTW), Delta will now be serving all seven of its U.S. hubs from SJC.

Volaris began serving SJC with flights to Guadalajara, Mexico in May 2010. The airline launched additional low frequency services to both Morelia and Zacatecas, Mexico in December 2017, and will begin flights to the fourth destination of Leon, Mexico in November of 2018. Volaris serves an important part of our air travel market, and the combination of Guadalajara and the three newly added cities establishes a wide variety of options for our customers.

California Pacific Airlines, known as CP Air, is launching its inaugural service under the California Pacific brand from its base of operations in Carlsbad, CA. Although CP Air is distinct from its existing Aerodynamics operation in Colorado, the new brand has announced flights to San Jose, Phoenix, Reno, and Las Vegas from Carlsbad, with plans for additional routes. As with SJC's previous new entrant airlines, CP Air faces substantial hurdles in establishing a presence in an already-fast growth marketplace. However, the Bay Area-Southern California travel corridor is consistently one of, if not the largest, travel markets in the U.S., and the introduction of flights to Carlsbad is offered as being complementary to existing services in a high population region.

Delta, Volaris, California Pacific Routes

Airline: Market:	Delta Detroit	Volaris Morelia	Volaris Zacatecas	Volaris Leon	CP Air Carlsbad
Total Airport Fees and Net Passenger Revenues	\$955,786	\$631,040	\$520,969	\$631,040	\$904,328
Total Airport Support	(\$249,521)	(\$82,925)	(\$80,295)	(\$82,925)	(\$81,204)
Net Impact Over Period	\$706,265	\$548,115	\$440,674	\$548,115	\$823,124

All amounts shown are net revenues to the airport during the initial support period for each qualifying route. Higher gross revenues benefit airport tenants.

After the expiration of the support periods, long term revenues associated with these routes will continue to benefit the financial situation of the Airport for all continued years of service.

EXECUTIVE SUMMARY

Within the last three years, Norman Y. Mineta San José International Airport's air service development initiatives, which include the Air Service Support Program, have yielded very substantial results. In calendar year 2017, SJC's total airline seat capacity growth of 15.4% topped 2016's 12.5% expansion. SJC led the nation's Top 50 major airports in percentage of seat capacity growth for the 2016-2017 period and appears well positioned to achieve a top tier status again in calendar 2018, currently projected to reach 14.2 million total passengers.

Since launching a broader strategic air service program in mid-2014, SJC has launched seven new airlines, nearly tripled the number of routes with airline competition (from eight to 22), and dramatically expanded the route network serving the City and its constituents. With the launch of the multiple routes outlined in the memo, the airport's route network becomes even more competitive and diversified. The Airport added 1.7 million total passengers in 2017, an increase of 15%, and is in position to see continued double digit growth through calendar 2018.

The Air Service Support Program facilitates the development of new air service at SJC, and is designed to help airlines offset high initial risks and costs to by waiving landing fees and/or providing marketing support where applicable. It is recommended to apply the support program to the new qualifying routes shown in this memo by Delta, Volaris, and California Pacific. The wider economic impact for the City resulting from these flights, determined by the Office of Economic Development's multipliers, is estimated to be as follows:

Delta Air Lines – Detroit, MI	\$9.8 million per year
Volaris Airlines – Morelia, Mexico	\$2.0 million per year
Volaris Airlines – Zacatecas, Mexico	\$1.5 million per year
Volaris Airlines – Leon, Mexico	\$2.0 million per year
California Pacific – Carlsbad, CA	\$4.8 million per year

The Airport's program, consistent with Federal Aviation Administration's policy, is not a subsidy to any airline, and remains revenue positive during temporary fee waiver/marketing periods due to the ongoing collection of non-waived fees such as offices, baggage space, and other exclusive use space rents. Other positive revenue generation sources related to the flights include Passenger Facility Charges, Customer Facility Charges, and revenues from concessions, parking, and car rentals. The program waives future fees and does not reduce current revenues or place added costs on others. From a fiscal perspective, however, the existing program continues to stipulate that any award of marketing dollars remains subject to the City Council's overall allocation of budgeted funds.

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 their strong desire to the Airport 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 take into account changes in the industry as well as competitive dynamics. In addition to the many new routes recently launched from SJC, the introduction of the new qualifying routes described in this memo continues to represent a strong endorsement of our market. These routes complement SJC's existing airline network through enhanced competition and additional options for both local travelers and visitors alike.

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:

- A 2016 survey of 25 U.S. airports including the airline hub cities of Denver, Houston, Detroit, and Phoenix confirmed that all 25 had air service incentive/support programs.
- Hartford, Connecticut's community-backed program also offers guaranteed revenues for specified new airline services.
- Dallas/Fort Worth International Airport has summarized a program of \$1.0 million or more for new qualifying international service.

This request to apply the Air Service Support Program to the new routes outlined in this memo is consistent with recent Council approvals for two new routes in June 2018, nine routes in February 2018, four routes in September 2017, three routes in April 2017, and five new domestic services in November 2016, as well as for previous approvals for Air China to Shanghai, British Airways to London, Lufthansa Airlines to Frankfurt, Southwest Airlines to Dallas, Alaska Airlines to Eugene, and Air Canada to Vancouver.

ANALYSIS

Air Service Support Program

The revised terms of the Air Service Support Program that are agendized for Council approval at the same meeting as this action are outlined in the summary table below. Additional details regarding each section follow the summary table:

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

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 up to 18 months of service

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

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 \$75,000 marketing funds for any new or additional frequencies to long-haul U.S. domestic destinations without airline match requirement
- Up to an additional \$100,000 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
- All marketing funds must be used to promote the specific route to SJC

Multiple Low-Frequency Routes

- At the discretion of the Director of Aviation, applicable landing fee waivers and marketing funds not to exceed \$100,000 may be awarded to an airline that introduces multiple low-frequency routes within a 12-month period, subject to City appropriation of funds.

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.

Recommended Support

Delta and Volaris have expanded their service from SJC and collectively have contributed to the substantial growth experienced in recent years. The addition of California Pacific Airlines provides yet another option for travel to the City's residents and business customers and introduces additional competition among airlines. The diversity among these routes is significant, appealing to a broad range of market segments and travel needs. Council support for these qualifying routes is recommended.

Delta, Volaris, California Pacific Routes

Airline:	Delta	Volaris	Volaris	Volaris	CP Air
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Marketing Funds	(\$75,000)	(\$33,333)	(\$33,333)	(\$33,333)	(\$25,000)

Landing fees are waived at 100% for the duration stated for each qualifying route, and marketing funds to promote the specific route to SJC up to the stated limits can be spent at the carrier's discretion with the coordination and approval of SJC staff.

EVALUATION AND FOLLOW-UP

The Air Service Support Program will 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.

POLICY ALTERNATIVES

Alternative #1: The City Council may choose not to approve the application of the Air Service Support Program in the cases of the qualifying routes outlined in this memo.

Pros: None.

Cons: If Council does not approve application of this program, chances of financial success of the routes will be put in jeopardy. The airlines might choose not to operate the service altogether, as other airports become better options for the allocation of aircraft. The support program is designed to enhance the ability to attract and support new routes to SJC to benefit the Airport and the City.

Reason for not recommending: Although international air service carries a high profile and speaks to the City's global reach, domestic expansion including the new routes being reviewed in this memo are the backbone of SJC's air service. Failure to offer support during the initial launch periods of service is contrary to similar competitive programs across the industry and would signal to our airlines that the City and SJC are not proactive partners fostering expansion. Without these and other prospective new services, SJC's revenue growth would be jeopardized and the economic impacts to the community would not take place.

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. The September 25, 2018 Council meeting will serve as the economic development subsidy public hearing in amounts in excess of \$100,000, as required pursuant to California Government Code Section 53083 and as further described in the Fiscal/Policy Alignment discussion below.

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 of new airline services and proposed program changes 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. The Office of Economic Development's financial multipliers were used to calculate the following City-wide economic impact statistics:

Delta, Volaris, California Pacific Routes

Airline:	Delta	Volaris	Volaris	Volaris	CP Air
Market:	Detroit	Morelia	Zacatecas	Leon	Carlsbad
Annual Economic Impact Estimates	\$9,827,018	\$2,004,278	\$1,504,888	\$2,004,278	\$4,765,256

The tables below address the requirements set forth in California Government Code 53083 for publication of information related to an economic development subsidy and a public hearing.

Delta, Volaris, California Pacific Routes

i. Name/address of beneficiary	Delta Air Lines 1030 Delta Blvd Atlanta, GA 30354	Volaris Airlines Av. Antonio Dovali Jaime Torre B, Piso 13 Col Zedec Santa Fe, Del. Alvaro Obregon C.P. 01210, Mexico DF	Volaris Airlines Av. Antonio Dovali Jaime Torre B, Piso 13 Col Zedec Santa Fe, Del. Alvaro Obregon C.P. 01210, Mexico DF	Volaris Airlines Av. Antonio Dovali Jaime Torre B, Piso 13 Col Zedec Santa Fe, Del. Alvaro Obregon C.P. 01210, Mexico DF	California Pacific Airlines 114 Townpark Drive Kennesaw, GA 30144
ii. Start and end dates for support	November 15, 2018 - May 14, 2019	December 15, 2017 - June 14, 2019	December 18, 2017 - June 17, 2019	November 17, 2018 - May 16, 2020	November 1, 2018 - October 31, 2019
iii. Description and estimated total amount of expenditures or revenues lost	Landing fee waivers of \$174,521 and marketing funds provided up to \$75,000	Landing fee waivers of \$49,592 and marketing funds provided up to \$33,333	Landing fee waivers of \$46,962 and marketing funds provided up to \$33,333	Landing fee waivers of \$49,592 and marketing funds provided up to \$33,333	Landing fee waivers of \$56,204 and marketing funds provided up to \$25,000
iv. Statement of purpose	The program is designed to enhance the ability to attract and support new commercial airline service and to benefit the Airport and the City				

v. Projected tax revenue (includes Airport fee revenue)	The increase in service to DETROIT is estimated to result in an additional \$0.7M in fees and revenues. Annual economic impact estimated at \$9.8M.	The increase in service to MORELIA is estimated to result in an additional \$0.5M in fees and revenues. Annual economic impact estimated at \$2.0M.	The increase in service to ZACATECAS is estimated to result in an additional \$0.4M in fees and revenues. Annual economic impact estimated at \$1.5M.	The increase in service to LEON is estimated to result in an additional \$0.5M in fees and revenues. Annual economic impact estimated at \$2.0M.	The increase in service to CARLSBAD is estimated to result in an additional \$0.8M in fees and revenues. Annual economic impact estimated at \$4.8M.
vi. Estimated number of jobs created	Employee requirements are being assessed by each airline with respect to new services being provided				

COST IMPLICATIONS

Funding from the Airport's Non-Personal/Equipment appropriation will fund the amount of \$200,000 to provide the necessary marketing funds for these qualified routes. The Air Service Support Program credits will continue to result in waivers of airline fees and charges for qualifying new air service. However, the increased revenue from parking, concessions, car rentals, Passenger Facility Charges, and other Airport services that will directly result from increased air service is expected to offset the short-term loss of revenue from waived airline fees and charges for qualifying new service. Additionally, the wider economic impact for the City resulting from these new flights has been exhibited in this document.

For the Airport Department, the impact of the Air Service Support Program for the flights discussed in this memo is a net positive result for each of the new routes for the duration of each route's specific qualifying period. The table below again summarizes the total net fees and revenues to the Airport compared to the combination of landing fee waivers and/or marketing funds provided to support the launch of each new service.

Delta, Volaris, California Pacific Routes

Airline:	Delta	Volaris	Volaris	Volaris	CP Air
Market:	Detroit	Morelia	Zacatecas	Leon	Carlsbad
Total Airport Fees and Net Passenger Revenues	\$955,786	\$631,040	\$520,969	\$631,040	\$904,328
Total Airport Support	(\$249,521)	(\$82,925)	(\$80,295)	(\$82,925)	(\$81,204)
Net Impact Over Period	\$706,265	\$548,115	\$440,674	\$548,115	\$823,124

The availability of the support program, including marketing funds, encourages new entrant carriers and existing carriers to add new destinations. As a result of this anticipated additional passenger-driven revenue, no increases in airline rates and charges are required to offset waived

airline fees and charges. Higher passenger marketing expenditure amounts will help support new flights and make the San José Airport much more attractive to airlines when choosing new destinations in the future, increasing the probability of adding new service and ultimately increasing airport revenues.

BUDGET REFERENCE

The table below identifies the fund and appropriation to fund the actions recommended as part of this memorandum.

Fund #	Appn #	Appn. Name	Total Appn.	Amt. for Contract	2018-2019 Proposed Operating Budget Page	Last Budget Action (Date, Ord. No.)
523	0802	Airport Non- Personal/ Equipment	\$41,215,297	\$200,000	X-3	06/19/18 Ord. No. 30124
Total Current Funding Available			\$41,215,297	\$200,000		

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.