



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: John Aitken

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

DATE: February 11, 2019

Approved

D. D. Sy L

Date

2/13/19

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 Southwest and Alaska 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:

Southwest and Alaska Airlines Routes

Airline: Market:	Southwest Nashville	Southwest Honolulu	Southwest Maui	Southwest Kona	Southwest Lihue	Alaska Dallas
Airport	BNA	HNL	OGG	KOA	LIH	DAL
Frequency	1 Daily	1 Daily	1 Daily	1 Daily	1 Daily	1 Daily
Support Period	18 Months	18 Months	18 Months	18 Months	18 Months	18 Months
Landing Fee						
Waivers	(\$174,521)	(\$174,521)	(\$174,521)	(\$174,521)	(\$174,521)	(\$89,416)
Marketing Funds	(\$75,000)	(\$75,000)	(\$75,000)	(\$75,000)	(\$75,000)	(\$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

Norman Y. Mineta San José International Airport (SJC)'s 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.

By summer 2019, SJC's largest carrier Southwest Airlines will have grown by nearly 60% since the summer of 2016, dramatically increasing its route network for San Jose travelers and visitors to Silicon Valley. With the addition of Nashville, Southwest will have 29 destinations compared to only 13 in 2016, and the airline's share of total SJC passengers will once again climb above 50%. Although Southwest is awaiting final FAA approval for its over-water flight operations to the four Hawaii destinations of Honolulu, Maui, Kona, and Lihue, this memo anticipates daily SJC service to begin sometime in the first quarter of 2019 based on statements from the airline. Those routes may be phased in based on aircraft availability and service priorities; marketing support and landing fee waivers will be applied based on actual service launches.

Alaska Airlines, SJC's second largest carrier, has also grown its operation significantly over the past three years, increasing its destinations from 12 to 20 and continuing to add frequency in key markets. By adding a second daily flight to Dallas Love Field, Alaska qualifies for additional marketing support and landing fee waivers beyond those initially approved by Council when the service was first introduced in 2018.

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Southwest and Alaska Airlines Routes

Airline:	Southwest	Southwest	Southwest	Southwest	Southwest	Alaska
Market:	Nashville	Honolulu	Maui	Kona	Lihue	Dallas
Total Airport Fees and Net Passenger Revenues	\$1,130,968	\$1,075,618	\$1,022,621	\$1,063,821	\$1,130,968	\$411,787
Total Airport Support	(\$249,521)	(\$249,521)	(\$249,521)	(\$249,521)	(\$249,521)	(\$114,416)
Net Impact Over Period	\$881,447	\$826,097	\$773,100	\$814,300	\$881,447	\$297,371

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

Calendar 2018 marked the third consecutive year that SJC has experienced double digit growth in total passenger volumes, surpassing the airport's all-time record of 14.2 million set in the 12 months prior to the tragic events of September 11, 2001. Over the three-year period since December 2015, SJC has led the nation's Top 50 major airports in percentage of seat capacity expansion and appears likely to capture the same position for passenger growth once all data has been submitted to the FAA.

Over the past five years, the Airport's strategic air service development initiatives, which include the Air Service Support Program, have contributed to a 63% rise in passenger activity, increasing from 8.8 million to over 14.3 million. Nonstop routes have expanded from 29 to over 50 and the number of competitive routes has nearly tripled, creating more competition and additional domestic and international travel options for the City and its constituents.

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 dedicated marketing support where applicable. Not every new route ultimately proves to be profitable, but SJC's program recognizes substantial airline investment and provides resources to demonstrate a strong partnership approach to the launch of service. It is recommended to apply the support program to the new qualifying routes shown in this memo by Southwest and Alaska Airlines. 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:

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Southwest Airlines – Nashville	\$10.9 million per year
Southwest Airlines – Honolulu	\$4.6 million per year
Southwest Airlines – Maui	\$2.5 million per year
Southwest Airlines – Kona	\$3.4 million per year
Southwest Airlines – Lihue	\$2.5 million per year
Alaska Airlines – Dallas	\$3.9 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 and significant challenges remain.

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.
- Pittsburgh International Airport has a multi-million dollar program to support new airline service in addition to waivers of landing fees.

This request to apply the Air Service Support Program to the qualified new routes outlined in this memo is consistent with prior Council approvals for multiple new routes in September 2018, June 2018, February 2018, September 2017, and November 2016, as well as for previous approvals for Beijing, Vancouver, and London.

ANALYSIS

Air Service Support Program

The terms of the Air Service Support Program 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

The Airport’s two largest carriers, Southwest and Alaska Airlines, have continued to expand their service from SJC and have collectively contributed to the substantial growth experienced in recent years. By mixing dynamic new destinations such as Nashville with competitive additions to Hawaii and Dallas, SJC remains more diversified in its ability to serve San Jose’s broad base of travelers. Council support for these qualifying routes is recommended.

Southwest and Alaska Airlines Routes

Airline:	Southwest	Southwest	Southwest	Southwest	Southwest	Alaska
Market:	Nashville	Honolulu	Maui	Kona	Lihue	Dallas
Airport	BNA	HNL	OGG	KOA	LIH	DAL
Frequency	1 Daily	1 Daily	1 Daily	1 Daily	1 Daily	1 Daily
Support Period	18 Months	18 Months	18 Months	18 Months	18 Months	18 Months
Landing Fee						
Waivers	(\$174,521)	(\$174,521)	(\$174,521)	(\$174,521)	(\$174,521)	(\$89,416)
Marketing Funds	(\$75,000)	(\$75,000)	(\$75,000)	(\$75,000)	(\$75,000)	(\$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 flights 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 February 26, 2019 Council meeting. The February 26, 2019 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:

Southwest and Alaska Airlines Routes

Airline:	Southwest	Southwest	Southwest	Southwest	Southwest	Alaska
Market:	Nashville	Honolulu	Maui	Kona	Lihue	Dallas
Annual Economic Impact Estimates	\$10,963,267	\$4,631,035	\$2,468,403	\$3,381,823	\$2,490,641	\$3,920,980

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.

Southwest and Alaska Airlines Routes

i. Name/address of beneficiary	Southwest Airlines 2702 Love Field Dr. Dallas, TX	Southwest Airlines 2702 Love Field Dr. Dallas, TX	Southwest Airlines 2702 Love Field Dr. Dallas, TX	Southwest Airlines 2702 Love Field Dr. Dallas, TX	Southwest Airlines 2702 Love Field Dr. Dallas, TX	Alaska Airlines 19300 International Blvd Seattle, WA 98188
ii. Start and end dates for support	June 9, 2019 - December 8, 2020	Anticipated to launch in 1Q 2019, 18 month support	Anticipated to launch in 1Q 2019, 18 month support	Anticipated to launch in 1Q 2019, 18 month support	Anticipated to launch in 1Q 2019, 18 month support	October 28, 2018 - April 27, 2020
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 \$174,521 and marketing funds provided up to \$75,000	Landing fee waivers of \$174,521 and marketing funds provided up to \$75,000	Landing fee waivers of \$174,521 and marketing funds provided up to \$75,000	Landing fee waivers of \$174,521 and marketing funds provided up to \$75,000	Landing fee waivers of \$89,416 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 NASHVILLE is estimated to result in an additional \$0.9M in fees and revenues. Annual economic impact estimated at \$10.9M.	The increase in service to HONOLULU is estimated to result in an additional \$0.8M in fees and revenues. Annual economic impact estimated at \$4.6M.	The increase in service to MAUI is estimated to result in an additional \$0.8M in fees and revenues. Annual economic impact estimated at \$2.5M.	The increase in service to KONA is estimated to result in an additional \$0.8M in fees and revenues. Annual economic impact estimated at \$3.4M.	The increase in service to LIHUE is estimated to result in an additional \$0.9M in fees and revenues. Annual economic impact estimated at \$2.5M.	The increase in service to DALLAS is estimated to result in an additional \$0.3M in fees and revenues. Annual economic impact estimated at \$3.9M.
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 \$400,000 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.

Southwest and Alaska Airlines Routes

Airline: Market:	Southwest Nashville	Southwest Honolulu	Southwest Maui	Southwest Kona	Southwest Lihue	Alaska Dallas
Total Airport Fees and Net Passenger Revenues	\$1,130,968	\$1,075,618	\$1,022,621	\$1,063,821	\$1,130,968	\$411,787
Total Airport Support	(\$249,521)	(\$249,521)	(\$249,521)	(\$249,521)	(\$249,521)	(\$114,416)
Net Impact Over Period	\$881,447	\$826,097	\$773,100	\$814,300	\$881,447	\$297,371

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 Adopted Operating Budget Page	Last Budget Action (Date, Ord. No.)
523	0802	Airport Non- Personal/ Equipment	\$41,215,297	\$400,000	X-3	06/19/18 Ord. No. 30124
Total Current Funding Available			\$41,215,297	\$400,000		

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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.