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Session #6

Transactions with Airlines

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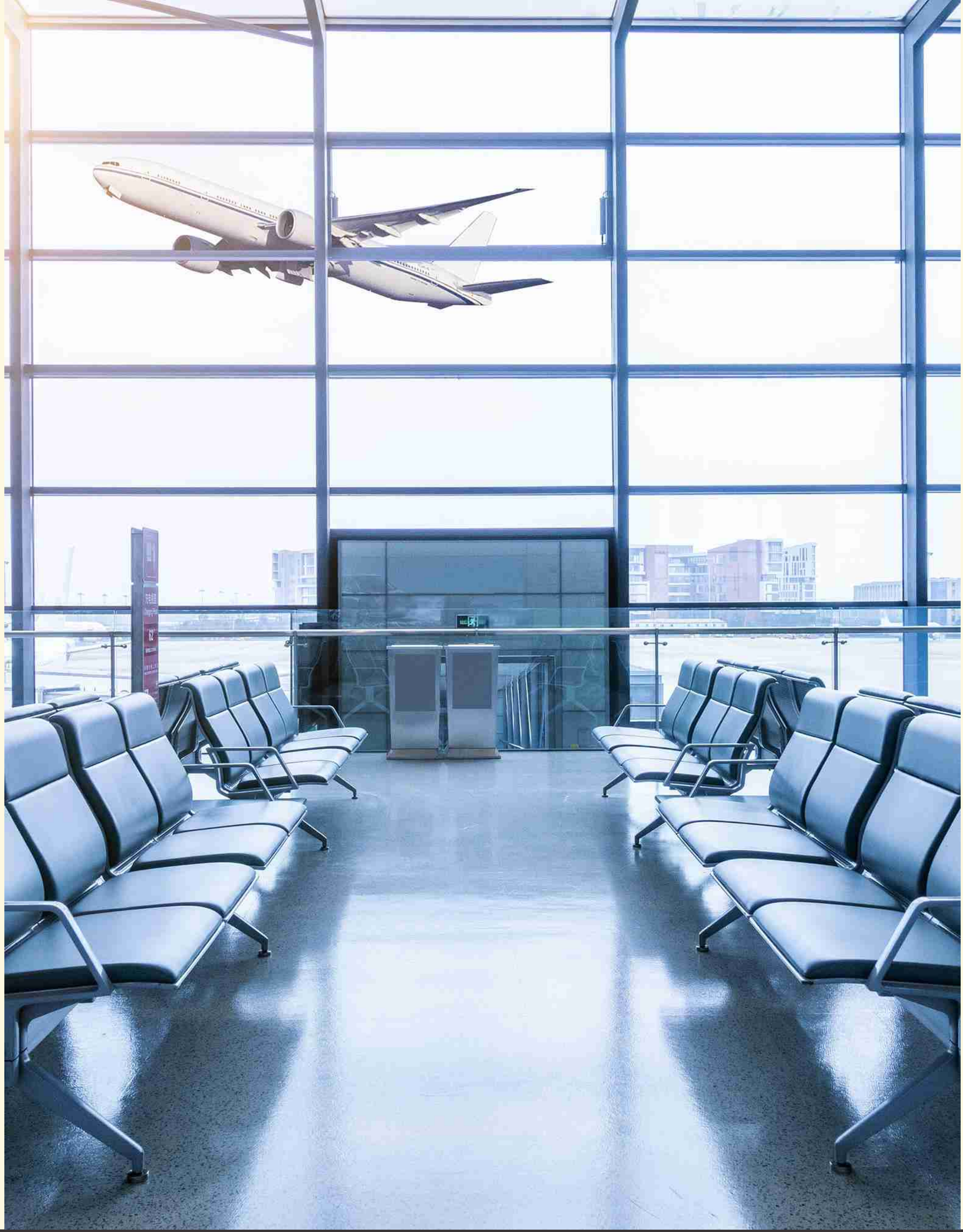
Today’s agenda

- **Overview**
- **Legal framework**
- **Setting rates with airline agreements vs. rates by ordinance**
- **Airport-airline negotiations**
- **Key considerations**
- **Major terms of an airline agreement**
  - Airline rates and charges
  - Gate use and assignment
  - Capital projects
- **Additional considerations**

Overview

Structuring the airport-airline relationship

- Most airport sponsors enter into airline use and lease agreements (AULAs) with airlines operating at their airport
- AULAs are unique form of lease
- Sets operating terms and conditions for the airlines, establishes airline rates and charges, and assigns space
- **Negotiating an AULA takes significant preparation and planning**



Overview

Structuring the airport-airline relationship

Not one-size-fits-all – but AULAs typically have similar key components.

Gate rights and assignment

Capital projects and airline input

Airline rates and charges

Legal framework

Different sources of legal obligations include:

- FEDERAL LAW
- GRANT ASSURANCES
- FAA RATES & CHARGES POLICY
- RULINGS AND PRECEDENTS
- BOND RESOLUTION

Setting rates with airline agreement vs. rates by ordinance

Airports have **two options**
for establishing airline rates and charges:

1	2
Airports and airlines reach agreement on rate-setting methodology & memorialize agreement in written contract	**Airport sets rates unilaterally** by law (e.g., ordinance, resolution)

Setting rates with airline agreement vs. rates by ordinance

Rates by ordinance still requires airline consultation & compliance with applicable federal law and regulation

- Nonaeronautical losses cannot be recovered through aeronautical revenues unless airlines agree
- Nonaeronautical revenues can – but do not have to be – shared with airlines
- Airport sponsor may still require airlines to execute written agreement (e.g., month-to-month or other short-term authorization for space, agreement to indemnify, etc.)

FAA Rates & Charges Policy

"It is the fundamental position of the Department that the issue of rates and charges is best addressed ***at the local level*** by agreement between users and airports."

FAA Rates & Charges Policy

*"**Airport proprietors** should give due regard to the views of aeronautical users and to the effect upon them of changes in fees."*

*"**Aeronautical users** should give due regard to the views of the airport proprietor and the financial needs of the airport."*

FAA Rates & Charges Policy

- Requires consultation before significant changes in fees or fee methodologies
- Airport must provide adequate information so airlines can evaluate justification for changes and assess reasonableness
- Airports and airlines should consider “public interest”
- Airports and airlines should make “good-faith effort” to reach agreement

FAA Rates & Charges Policy

Appendix 1—Information for Aeronautical User Charges Consultations

Expands on information airport sponsors should ordinarily make available to permit "**meaningful consultation and evaluation of a proposal to modify fees**"

1. Historical financial information
2. Economic, financial, and/or legal justification for changes in methodology or level of aeronautical charges
3. Information about aeronautical costs to be included in the rate base
4. Historical traffic levels
5. Planning and forecasting information to the extent applicable to setting fees (e.g., for major capital projects)
6. Current and proposed airport budget, including O&M and capital expenditure estimates
7. If residual or hybrid, factors that may affect current and future commercial or nonaeronautical revenues

Grant Assurances

Grant Assurance 22

- Cannot unjustly discriminate among similarly situated users when setting terms and conditions
- OK to discriminate based on reasonable classifications/distinctions (e.g., signatory vs. non-signatory, tenant vs. non-tenant)

Grant Assurance 23

- No exclusive rights

Grant Assurance 24

- Must set rates that make the airport as self-sustaining as possible in the circumstances

Grant Assurance 29

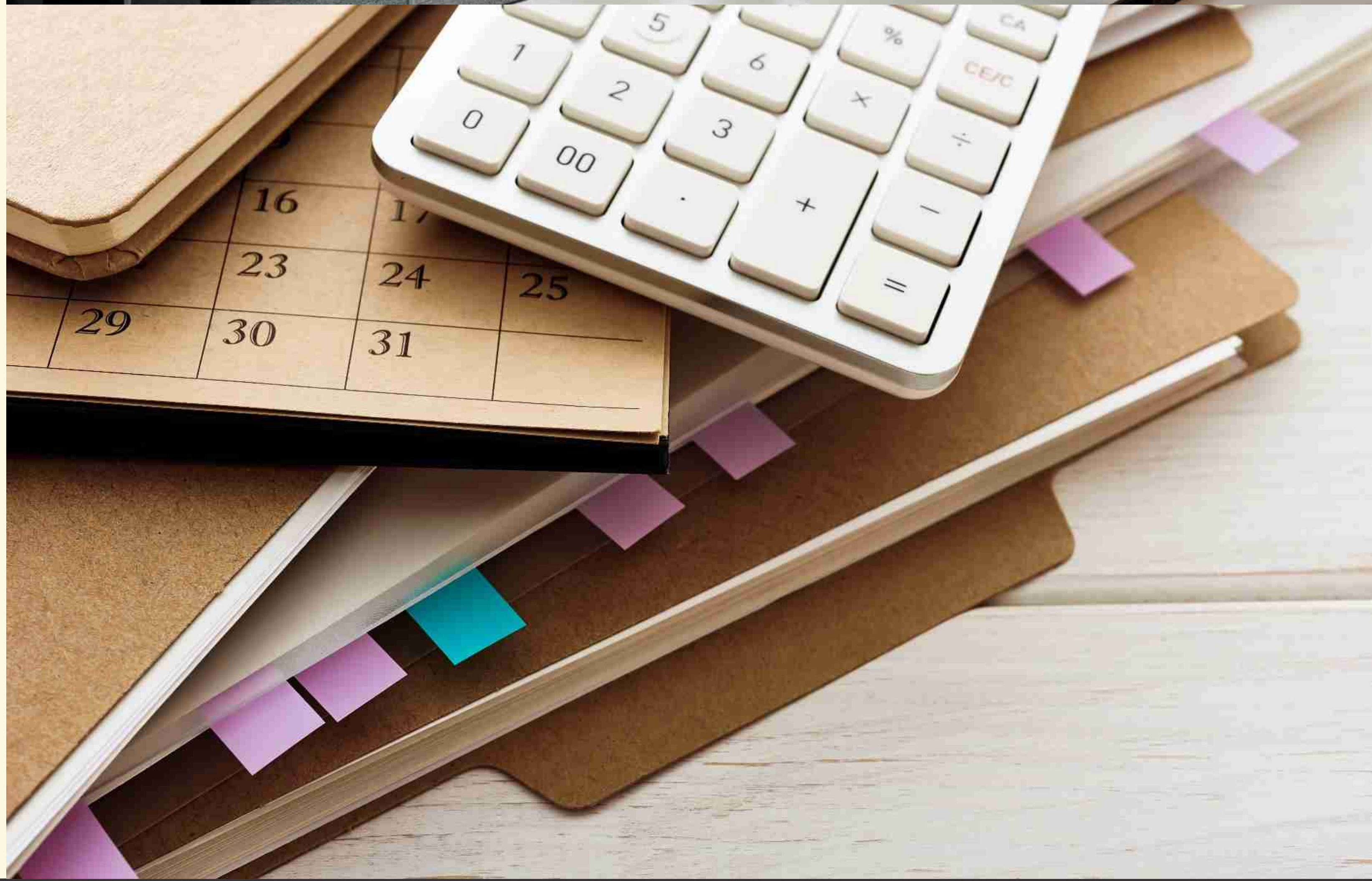
- Competitive access reports

…and more!

Airport-airline negotiations

How should the airport prepare prior to commencing negotiations?

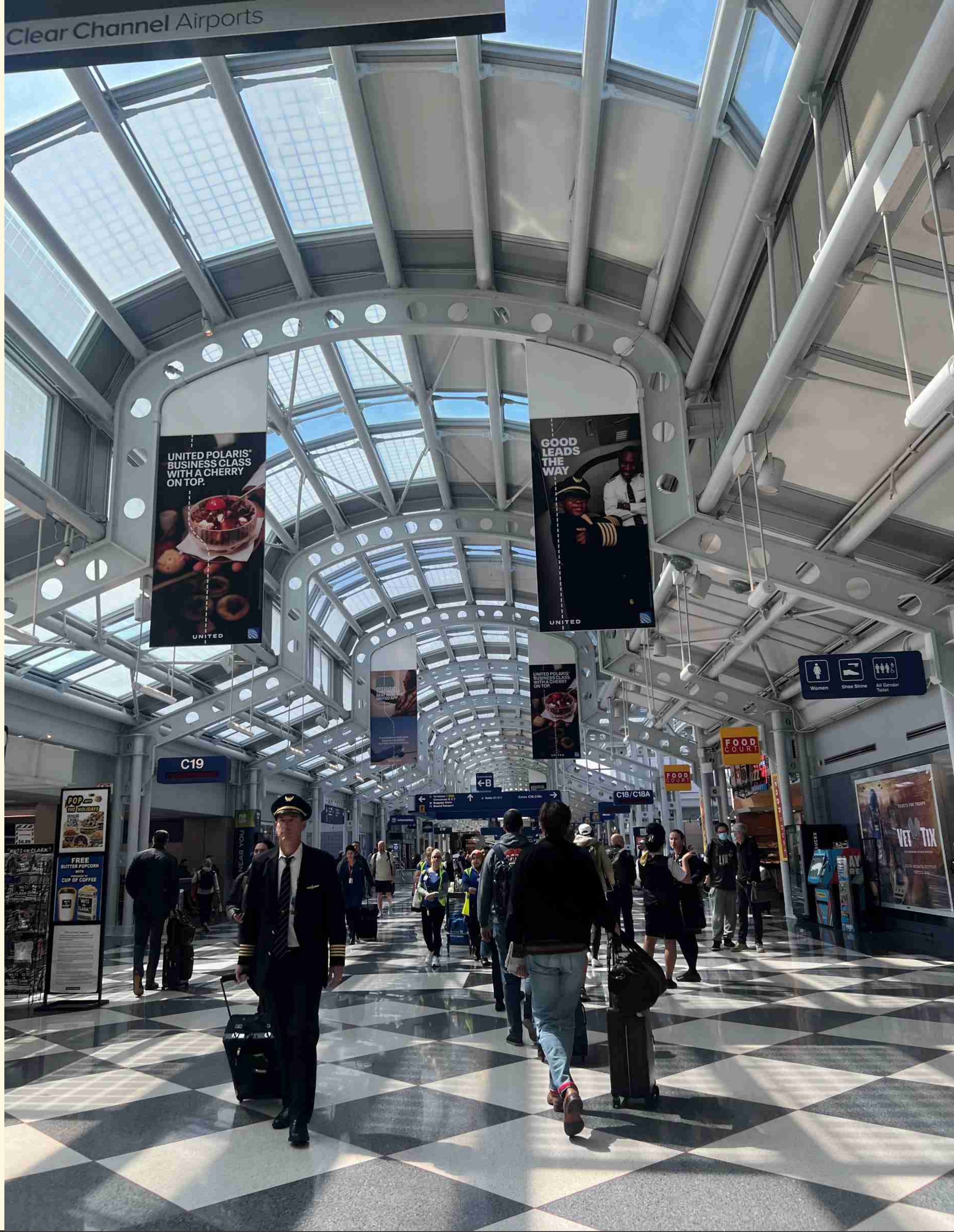
- Typically recommend ~18 months to negotiate a new airline agreement (and need ~3 months for final airline review and execution)
- Airport and representatives from each airline negotiate a form of airline agreement, with each airline eventually signing their own document
- Core team: airport staff, rates and charges consultant, counsel, subject matter experts



Key considerations

What does the airport need to consider when setting goals for negotiations?

- What capital projects and spending are needed at the airport during the term?
- Is the airport gate constrained?
- What mix of airlines operates at your airport (e.g., legacy, ULCC, hub, etc.)?
- When was your agreement last updated?
- What is average cost per enplanement (CPE)?



Major terms of an airline agreement

What do both sides care about the most?

Airline rates and charges

Establishes a methodology for charging airlines for the use of airport facilities and services

Gate use and assignment

Sets up the way gates are assigned and used by airlines

Capital projects and spending

Includes structure for airline input into airport capital spending

Airline rates and charges

How will airlines pay for their use of airport facilities? How will airport sponsors pay for capital expenditures?

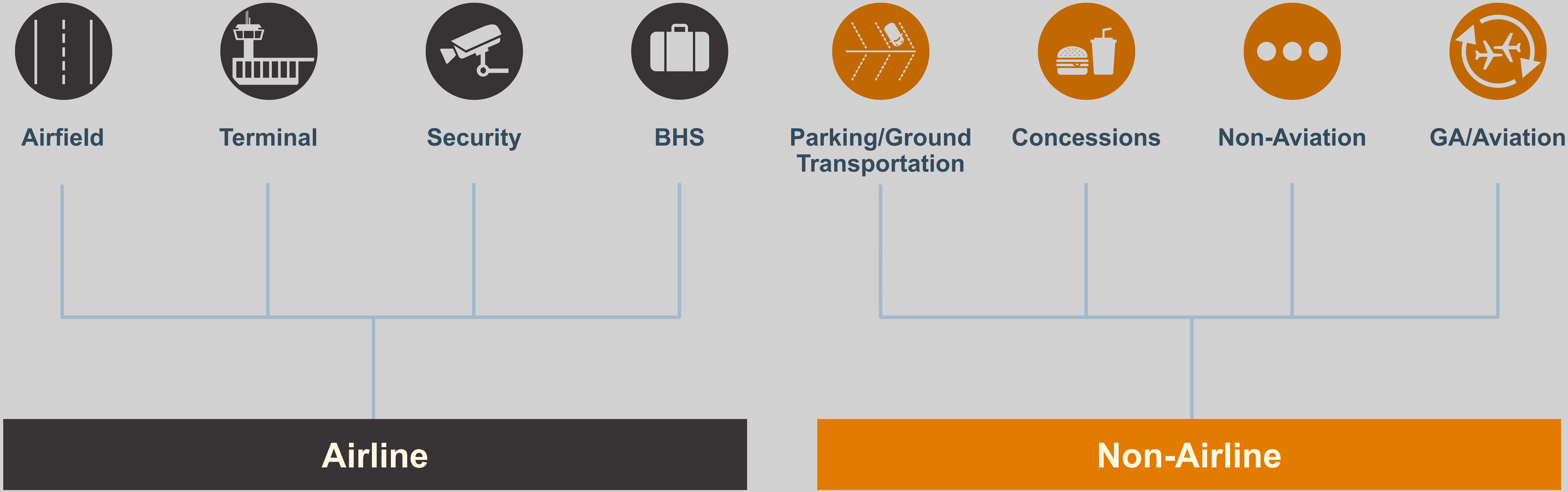
- Different rents, fees, and charges for preferential space, common use space, and joint use space (e.g., baggage handling systems)
- Inclusion of capital costs in airline rate base
- Sharing of nonaeronautical revenue

Framework decisions

"If you've seen one airport…"

- Airport Cost Centers
- Amortization/Depreciation
- Revenue Sharing
- Reserve Requirements
- O&M Expense Allocations
- Classification of Terminal Space
- Debt Service Coverage
- Fund Balance Targets

Cost centers



Three types of rate-making methodologies

RESIDUAL

- **Recover net costs after credit** of nonairline revenues
- **Financial risk transferred** to airlines
- Usually **requires airline approval** on capital decisions

COMPENSATORY

- **Recover only costs** allocated to **occupied facilities**
- Airport **assumes financial risk**
- Only pay for what you use
- **Airport keeps nonairline revenues**

HYBRID

- Mixture of both methodologies
- **Balance of risk and facility control**
- Carve outs of self-supporting cost centers
- **Net revenue-sharing formulas** (usually in return for "safety nets")

Rates by Airline Agreement

Rates by Ordinance

Defining useable terminal space

Rate methodology distinguishes between leasable vs. non-leasable space

- Cost recovery for non-leasable space
- Commercial compensatory vs. other methods
- Important to properly measure and classify space

NON-LEASABLE TERMINAL SPACE

- PUBLIC CIRCULATION
- RESTROOMS
- AIRPORT ADMINISTRATIVE OFFICE
- TSA CHECKPOINT / OFFICE

LEASABLE TERMINAL SPACE

AIRLINE

- PREFERENTIAL & EXCLUSIVE USE *(1 Airline has rights to space)*
- JOINT USE *(2+ Identified Airlines have rights to space)*
- COMMON USE *(All Airlines have rights to space)*

NON-AIRLINE

- CONCESSIONARE SPACE *(Business with Lease of Space)*
- RENTAL CAR *(Business with Lease of Space)*

Revenue sharing and competitive credits

Airports often use nonaeronautical revenues to reduce airline rates and charges

Airlines and airport may negotiate revenue sharing structure into AULA

- Airlines share risk of nonaeronautical losses in order to share upside of additional revenues
- Incentivize new entrants and new service

Airport may retain discretion in AULA or rate ordinance to apply nonaeronautical revenues to reduce airline rates and charges

Revenue sharing and competitive credits

REVENUE SHARING PRACTICES	EXAMPLES
Airport Maintains Set Thresholds Before Revenue Sharing	If 75% of net revenues is greater than $15 million, then the remaining 25% will be shared with signatory airlines.
Specified Revenue Type	Airport sponsor will pay 35% of the net remaining terminal revenues to signatory airlines.
Percent of Net Remaining Revenues	15% of all airport net revenues for signatory airlines.
Revenue Sharing Based on Specified Growth Targets	$1 per signatory airline enplaned passenger up to 8,000,000. If airlines exceed this amount, airport sponsor will increase revenue sharing for that increase.

Per turn or per use fees

Alternative to charging on leased square footage basis for gates or other facilities

- **For low frequency and/or legacy carriers**
- **More important as airports are space constrained**
- **Incentivize efficient utilization of facilities**
  - Leased gate vs. use per turn
  - Recover costs
- **Several variables in turn fee:**
  - Average turns per day per gate
  - Fully loaded cost or separated out for use (holdroom, loading bridge, ramp, ticket counter, etc.)
  - Non-signatory premium

Gate use and assignment

Preferential rights vs. common use rights

- No industry standard definitions

Principles to consider:

- Recapture of underutilized gates
- Forced accommodation
- Priorities for assigning use of common use gates

Categories of airline space

Airline agreement defines rights granted to airlines to different categories of space for (1) rates and charges purposes and (2) facility management and control

COMMON

Airport assigns or available for all

- Gates
- Ticketing
- FIS
- Circulation
- Restrooms

JOINT

Two or more airlines use jointly

- Baggage Handling
  - Avoid paying costs of others

PREFERENTIAL

First right, airport may assign others if not in use

- Ticket Counter
- Gates
- Holdrooms

EXCLUSIVE

Exclusive right to use

- Ticket Counter
- Airline Offices
- Operations Space
- Clubrooms

Common Use Terminal Equipment (CUTE)

Airport-managed systems at gates, ticket counters, etc. with CUTE can accommodate more airlines

Often desired by airlines for option to maintain proprietary equipment

- Proprietary back walls and systems
- CUTE often not 100% compatible
- Data protection

Technological change – good and bad

- More flexible use of facilities
- Trend towards e-tickets
- Allocation of O&M responsibility, liability, and cost

Capital projects and spending

What level of control will airlines have over airport's capital-related decisions and expenditures?

Pre-approval of anticipated capital projects

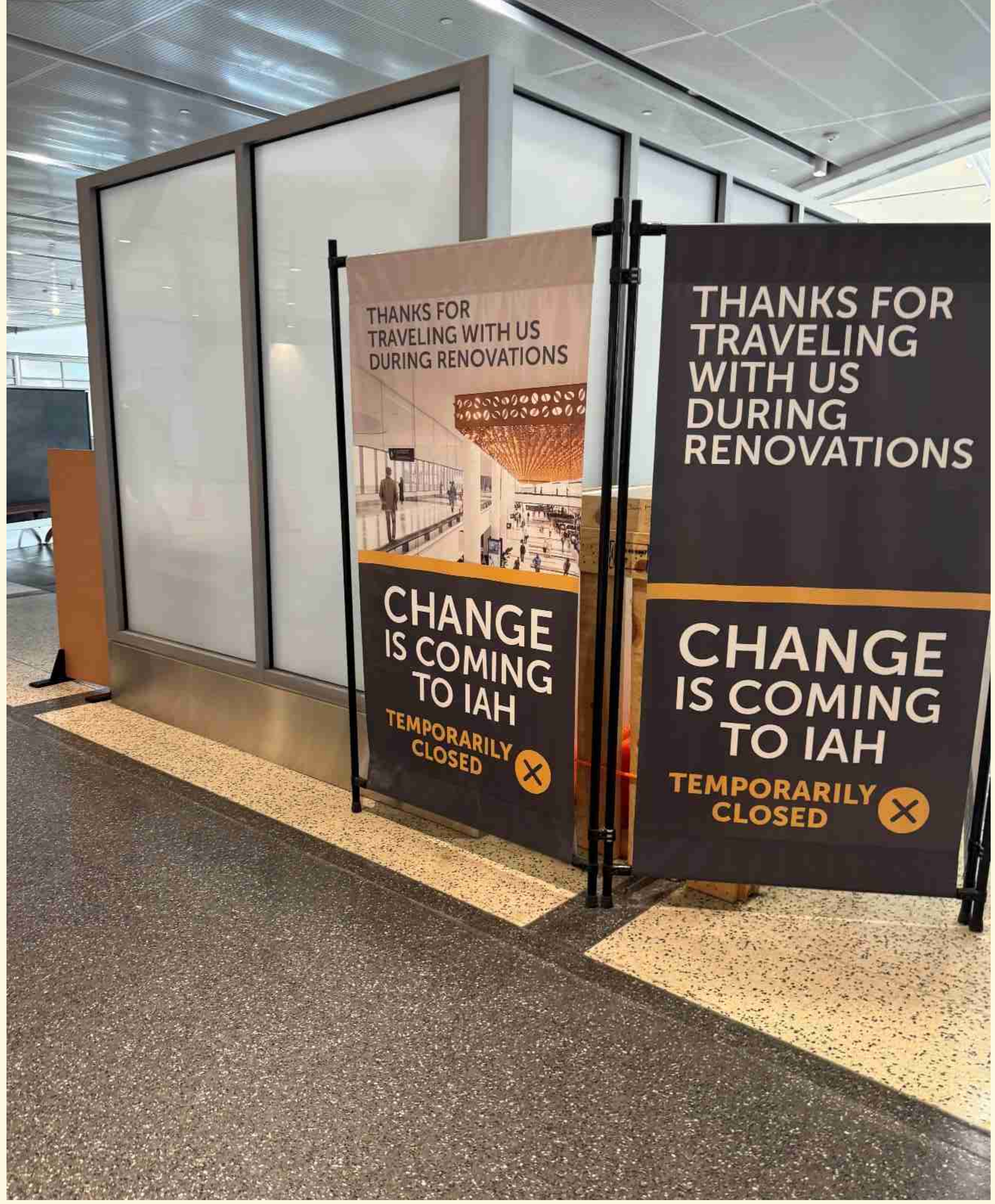
- When capital needs are known, airlines can pre-approve certain costs/scope through execution of AULA

Majority-in-interest (MII) provisions

- Metric of landed weight, enplanements, etc.
- Changes in cost or scope of previously approved projects
- Exemptions to MII process

Airline participation in capital program governance

- Often negotiated into airline agreement when large capital program is being undertaken in connection with new agreement
- Role of airline technical representative (ATR)



Capital projects influence rates and charges

CAPITAL PROJECTS

- Terminal
- Airfield
- Apron
- Roadway
- Cargo
- Parking
- Repairs
- Rental Car
- Other

FUNDING PLAN

- Federal/State Funds
- Airport Operator Funds
- PFC Funds
- Other/3rd Party Funds
- Revenue Bond Proceeds
- Customer Facility Charges (CFCs)

OTHER FUND DEPOSITS
(e.g., operating reserve, R&R)

Existing Debt Service and Amortization

Additional Debt Service and Amortization

Annual Debt Service and Amortization

Existing Operating Expenses

Additional Expenses

Annual Operating Expenses

AIRPORT COSTS

AIRLINE RATES AND CHARGES

- Landing Fee
- Terminal Rentals
- Other Airline Fees

Existing Nonairline Revenues

Additional Nonairline Revenues

Annual Nonairline Revenues

AIRPORT REVENUES

AIRLINE COST PER ENPLANED PASSENGER

NET REVENUES AND DEBT SERVICE COVERAGE RATIO

Additional considerations

What else goes into an airline agreement?

- Term, extensions, holding over
- Environmental, insurance, and indemnification
- Division of operations and maintenance responsibilities
- Assignment and subleasing
- Default and termination

…Exhibits!

- Affiliate forms
- Federally required provisions
- Maintenance matrix
- Non-signatory agreement
- Space exhibits

Questions?

Thank You!