Third Interim Review of the 2019 Determination at DUB airport

IATA response to CAR's Draft Determination

This submission presents the response of the International Air Transport Association (IATA). IATA's mission is to represent, lead and serve the airline industry and brings together some 290 airlines or 83% of the global air traffic.

IATA welcomes the opportunity to provide comments to the Commission for Aviation Regulation on the Draft Determination of the Third Interim Review of the 2019 Determination of the maximum level of airport charges at Dublin Airport.

Approach to Regulation

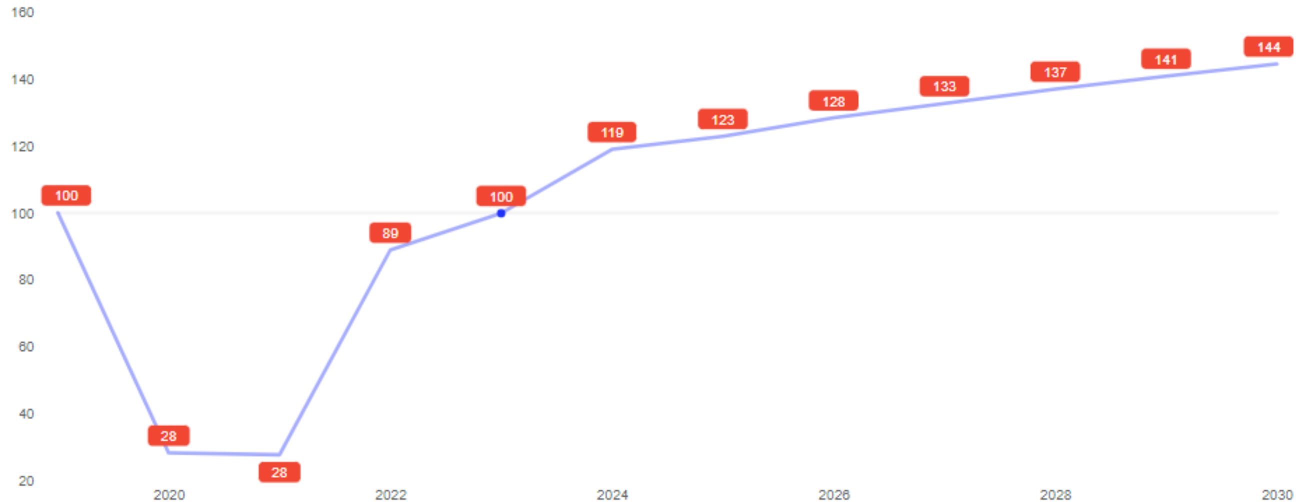
In relation to the decisions made by the CAR and explained in the approach to regulation section, we have the following commentaries:

- Risk allocation: We agree that there is no need for the implementation of a traffic risk sharing mechanism, since traffic is becoming more predictable (in terms of being subject to the normal economic cycles)
- Extreme downsides: As previously mentioned, we agree with the not implementing an automatic adjustment for extreme downsides, since decisions need to be made "in the round".
- Length of period: We understand and agree in the implementation of a shorter period (4 years).

Passenger Forecasts

- IATA has recently updated its forecasts (as of 1 Sept) for Ireland. In this regard, the unconstrained forecast demand for the country is shown in the figure below (2019 traffic = 100).

Ireland



O&D Passengers per year, 2019 = Index 100
Source: IATA/ Tourism Economics Air Passenger Forecast

Last updated
Thursday, September 01, 2022

IATA agrees with CAR that the traffic forecast figures are likely to be materially higher than the projections provided in Dublin Airport's proposal and therefore supports amending the passenger forecasting methodology with an approach that relies on a mix of market information for short term forecasts until full recovery is achieved. IATA's own traffic forecasts and the airlines' booking reports and capacity plans, reflect that a strong rebound in traffic is underway.

Operating Expenditure

General approach:

- We support the bottom-up analysis using an assumption of an efficient 2022.
- Risk allocation/pass through: As mentioned in our response to the issues paper, pass-through costs shall be kept to a minimum. The proposed elements to be subject to a pass-through mechanism appear to be acceptable.
- VSS: Since the VSS has already recovered its costs, there is no point in further discussing whether there should have been an allowance.
- Rolling scheme: We agree that it would be wise not to introduce one.
- Assumptions: We generally agree with the approach taken in the CEPA study and appreciate the level of thoroughness in its analysis. We have the following specific commentaries for the CAR/CEPA consideration:
    - CEPA specifically states that it is not assuming any reduction in unit costs once new staff are hired. We recommend that this is looked at before the final determination. If there are concerns that a

"learning curve" could counterbalance this effect through lower productivity, then CEPA should seek for such information, rather than just assume these effects cancel out.

- There are several instances in which CEPA adopts Dublin airport's 2022 numbers despite the lack of justification provided by the airport. This should be looked at prior to the final determination.

- It is mentioned that Dublin airport reduced the level of maintenance during 2020 and 2021 and that maintenance costs are expected to increase to compensate for maintenance that was deferred. This may lead to a double counting of costs (the situation is equivalent to making an allowance for a capex project that was not delivered, and then making the same allowance in the following period).

- When commissioning new assets there is usually a ramp-up period in maintenance costs. In this respect, it would be useful to have CEPA further explain the reasoning behind the EUR 1.5m non-pay maintenance from C3 starting in 2024.

- We would also appreciate CEPA further analysing marketing costs in order to better understand if "marketing and promotional costs" are really needed (i.e., what are the benefits for users from these activities). Regarding "airline support", IATA would like to understand the difference between these costs and the incentives schemes offered by the airport.

Commercial Revenues

General approach:

- We understand the aim of the rolling incentive scheme. However, it needs to be appropriately calibrated in order to ensure that actual outperformance is remunerated. As mentioned in previous submissions, the CAR sometimes had difficulties in explaining whether deviations in opex and non-aeronautical revenues from the forecast are due to outperformance or because the forecast was incorrect.

- We find acceptable the approach of using a 2023 baseline and apply elasticities from there. However, and as explained in previous submissions, IATA remains concerned that the elasticities are calculated against DUB own historic performance rather than assessing whether other airports have been able to achieve more.

Comments on assumptions

- Retail: Agree with the recalculated elasticity. However, it would be appropriate to further explain the uplifts (as these are just inputs in the financial model and we have not been able to find the explanations), particularly for the case of Brexit. The CAR further states that these uplifts are potentially conservative, which then raises the question on why there should be a rolling incentive applied to them (if they are relatively easier to achieve).

- Car parking: We note the CAR comments that since car parks are yield managed, capacity constraints would not be inconsistent with an elasticity greater than one. However, it then reduces the historic elasticity to 1.55 to 1 (and only allow uplifts on from car park investments). We would appreciate CAR reconsidering the approach or once again reconsider the rolling incentive targets.

- Commercial property: We would appreciate further explanations as to the reductions in revenue assumed from the North and South Apron displacements.

- ATI: Agree with the need for capping these charges in order to avoid the airport from maximizing revenues from activities that are essential to aviation.

- Lounges/Fast track/DATS: Applying an elasticity of 1 appears to be conservative considering the historic evolution of this revenue line.
- Pre-clearance: The CAR is assuming that US Preclearance charges will be maintained constant on a real basis. What would prevent Dublin airport from increasing charges at higher rates? Since the CAR is considering this revenue as "commercial" there is no recourse for airlines if such charges increased at higher levels. This once again raise the issue on whether this service should be "cost based".
- CAR is not assuming any revenue from sustainability projects (i.e., public charging facilities). Can it be confirmed that implementation will fall outside of the end of the period?

Cost of Capital

We understand that the calculation of the cost of capital is mainly based on the methodology used on the 2019 determination. The comments below mainly focus on areas where there has been a change in the approach:

- Cost of debt:
  - New debt: It is unclear as to why the Swiss economics shifts to utilizing longer maturity indices. While SE does mention that this is linked to the maturity of DUB's debt, SE has not made an assessment whether taking such longer period is financially efficient. Since in normal circumstances the longer the tenor, the higher the rate, this needs to be appropriately justified.
  - Embedded debt: Noting that the inflation rate is higher than what the CAR assumed in the draft determination, the real cost of debt for embedded debt should be reduced accordingly.
  - Weightings: We note that SE has used the same weightings for embedded and new debt as those used in the 2019 determination (62:38). Since the level of debt has more than doubled since the determination, this would suggest that there should be a bigger weighting for the embedded debt.
- Equity beta:
  - We agree with the approach to use solely non-pandemic beta, particularly on the fact that the CAR did intervene and modified the settlement. What is yet unclear is why only 2020 was removed from the calculations, and not a bigger period (e.g., after the omicron wave). It should also be noted that the CAR's interventions covered more than just 2020. In this regard, we consider that the non-pandemic should re-start somewhere in 2022 (or even in 2023)
- Risk free rate:
  - Similar to the comments on the cost of debt re inflation, the real risk free rate may also need to be updated.
- Equity risk premium
  - We note that SE continues to use the TMR approach to calculate the ERP (TMR-RFR=ERP). While this is a methodological aspect that has not been changed since the 2019 determination, we would like to highlight that this is not the approach applied in Continental Europe (where the RFR and ERP are calculated separately). We would appreciate for the CAR to reconsider.

- Aiming up:
    - We continue to believe that there is no need for an "aiming up" component in the WACC, nor do we agree with SE arguments to maintain it:
        - The risk of measurement errors could be positive or negative. We don't see why there is a need to shield the regulated company from potential negative errors but allow them to benefit from "positive" ones. The beta should be lowered since risks are being removed from the company.
        - Similar to the above, there appears to be a need to overcompensate the company in order to ensure that the capital expenditure is delivered.
        - There is an explicit financing adjustment, so we remain unsure as to why there an aiming up allowance
- Separately, we note that the financial model assumes that DUB will maintain cash & equivalents of EUR 758m throughout the period (this can be obtained by calculating the difference between Total Debt and Net Debt in the Financial model). We would like to know whether this unrealistic scenario is affecting in any way the regulator's decisions on financeability/costs. This could for example, affect the assumptions of the share between embedded and new debt.

Capital expenditure

The Capital Investment Plan (CIP) is substantial; however, many of the projects extend beyond the 2023-2026 period. It is understood that they need to be approved in their entirety from a commitment and cost allowance perspective as it provides more certainty for construction financing and planning.

- The overall content of the CIP is in the interests of users with a clear need for most of the core and capacity projects. The size and range of the CIP does evoke concern over whether the required resources will be available to bring it to fruition.
- Much of the detailed planning is yet to be completed; therefore, IATA recognizes the need to have triggers for projects that require an extended planning period.
- The stage gate process and quarterly reporting on costs and delivery progress will be vital to managing such a large program and providing flexibility with regards to scope and costs.
- The priority and timelines for projects should be reviewed as it appears that capacity constraints in terms of aircraft stands, and terminal facilities will start to have an impact well before scheduled completion of these projects according to the GAP analysis presented by Dublin Airport.
- The remuneration of projects at 80% when full planning permission is received is not reasonable and challenges ICAO's key charging principle of cost-relatedness. Only assets in use should enter the RAB and therefore be renumerated. IATA acknowledges that it is critical to get many of the projects underway; however, all financing options should be explored and exhausted before resorting to prefunding.
- The airport sustainability investments should be targeted, proportionate and effective. The provision of FEGP, for example, potentially offers clear benefits to the airport and its users in terms of efficiency and carbon reduction. IATA looks forward to learning the specifics of the initiatives including their environmental benefits as they are further developed and subject to further consultation. Airport green infrastructure investments are required but should be held to the same standards and scrutiny as other capital spending plans to ensure the best possible results.

Financing and financial viability

- We understand the need to have an airport that remains financeable. We also understand that financeability is normally measured against financial ratios thresholds applied by Credit Rating agencies. We also understand that the CAR is bringing forward depreciation (a non-cash cost) to generate a higher level of revenue so that DUB can meet such target ratios.

- However, there is one fundamental issue with the approach: the CAR assumes that the financing is either through debt or retained earnings. Equity injection is not considered at all. Users cannot be used to bail out a shareholder from its responsibilities. This is not reflective of what would happen in a competitive environment. And to put fuel to the fire, the CAR is assuming a dividend pay-out (in the baseline scenario).

- If a financeabillity adjustment is unavoidable we do prefer that this is in the form of bringing forward costs rather than setting artificial (i.e., excessive) profits just to meet the targets. This should not be misinterpreted as IATA supporting prefunding. Once again, we believe the financeability issue should be sorted through an equity injection.

- Before considering the need of any financing adjustment, the CAR should consider an equity injection assumption in its forecasts. Otherwise, it should at least not consider a dividend payout in the base case.

Quality of Service

IATA agrees with CAR's proposal to fully reinstate the Quality-of-Service (QoS) regime in 2023. IATA supports the change in the language from the word 'penalties' to 'adjustments' or 'rebates' but fundamentally disagrees with the use of bonuses as what airlines expect from the airports is the performance that they pay for through aeronautical charges – nothing more and nothing less.

The current QoS is a good starting point and could be further enhanced in the future. For example, targets may be reassessed to reflect changing processes and passenger expectations. In addition, a broader set of measures to assess other aspects of the passenger journey and airport operations may be included for monitoring purposes.

Other issues

Incentive schemes: As part of the justification process of an incentive scheme or modulation, the airport should demonstrate that the variation will lead to the intended objective. Otherwise, the scheme will just end up distorting the market with no apparent benefit for the consumer.

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