DublinAirport

Dublin Airport's Response To The Commission's Draft Decision 2022

September 2022

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Disclosure

The Dublin Airport response to the Commission's Draft Decision for 2023-2026 has been compiled with the principles of regulation in mind, it is a good faith commercial document. If there are inconsistencies between this proposition and previous regulatory submissions relating to matters of regulatory policy, then those submissions take primacy. In developing the Dublin Airport response, we have taken an approach to assurance which is both comprehensive and appropriate. However, given the inherent uncertainties that the aviation industry is currently facing, it is likely that material updates will be necessary throughout 2022. Dublin Airport will not accept or assume any responsibility or liability for the accuracy or correctness of the information or of any figures provided, calculations or any assumptions that may be drawn from them.

Foreword

Dublin Airport welcomes that the Commission has recognised that the circumstances and impacts of the pandemic over the past 2 years, alongside the profound industry volatility, necessitate setting aside the previous regulatory Determination. As part of the current Review, it is imperative that the Commission provide adequate regulatory allowances for key areas such as operating expenditure and the Cost of Capital. It is essential that the Commission take account of the uncertain macroeconomic environment and a number of downside risks currently facing the airport, where a financially viable price path for 2023-2026 is applied.

The Commission's current proposals do not provide sufficient funds for Dublin Airport to return to resilient operation post COVID-19. The aviation industry is going through an uncertain, volatile recovery from a shock that has caused significant disruption to operations and to finances globally. Steady state functioning will take time to achieve, and Dublin Airport faces the challenge of restoring service levels and reliability for customers while delivering on a multibillion-euro airport improvement programme. We have the lowest charges of our peer competitors in Europe and will continue to do so even after the modest increase we have proposed, which will significantly improve the airport experience for all stakeholders.

The airport needs to be financeable - it cannot continue on the same basis as the last three years. The proposed settlement is not achieving our financeability requirements. The building blocks in the draft decision deliver revenues and cash flows that collectively do not support financeability. The Commission's own assessment recognises this. The Commission's solution to advance future depreciation was rejected as a legitimate solution to solve financeability by the UK CMA. By the end of 2026, over €220m (Feb 2022 prices) will have been brought forward from future periods and used as financeability adjustments over the period since 2010. This RAB reduction will weaken financeability of future periods and result in annual price caps being c. €0.50cent lower all other things being equal. There is no legitimate justification for the Commission's approach.

The Commission's proposals recognise the need for important capital investment with a particular focus on sustainability but they do not allow Dublin Airport to rebuild from the pandemic, provide the service that customers need and Ireland deserves. We strive to be efficient, but the Commission's errors, particularly in operational expenditure and cost of capital are concerning and have substantial consequences.

Operating expenditure needs to be [redacted] higher to take account of the current economic environment. Wage inflation and staff shortages are increasing the efficient cost of driving airport recovery and a return to business-as-usual operations. Planned resources are for a minimum standard of service - but this is not what customers expect post-pandemic. Additional cleaning, security and sustainability are now base case expectations. The Commission's assumption that the airport can run a full, reliable service at pandemic-level costs is not aligned with the available evidence and economic reality.

The Commission's cost of capital assumptions imply that Dublin Airport faces less demand risk than Heathrow and less demand risk than in the 2014 Determination. This does not make sense. While we aspire to be as successful as Heathrow, we know that airlines can and do move flights. Over 51% of Dublin Airport's passenger traffic flies on low cost carriers, compared to none at Heathrow, and these

are highly mobile between routes. Taking into account the current risk exposure facing the airport, we estimate a cost of capital of at least 5.3 per cent, around 1 percentage point higher than the Commission's assumed 4.2 per cent.

The Commission's regulatory approach has worked well in a steady-state, benign environment where the airport can hone its offering and focus on efficiency. In 2019, the outlook was positive - the situation now is very different. Recessionary fears and the ongoing risk of further covid variants on the demand side are compounded by a normalisation of the post-lockdown travel peak which is now subsiding. With many of the parties providing the overall airport experience struggling to rebuild capacity, Dublin Airport plays an increasingly pivotal role in service coordination, with a regular need to step in to ensure the system as a whole works smoothly. If Dublin is funded as a 'yellow pack' airport we will not have the service levels or resilience to manage disruptions to our own - or other airport parties' - services.

If these proposals are applied, Dublin Airport will need to delay investment, continue to restrain the service offered and accept lower levels of resilience, with a consequent degradation in experience for passengers. This would not maximise customer welfare. Customers want service back to pre-COVID levels, which matches the Commission's approach in the Review. Passengers place quality and reliability of service and experience ahead of the minimum charge. Numerous passenger surveys have shown that the travelling public, regardless of understanding of airports price control application are willing to pay more for better service quality in the airport[1].

We have worked hard to manage through the challenging last few years. We encourage the Commission and all stakeholders to think about that potential benefit and delivery of statutory duty before taking the final decision.

[1] FTI Consulting, Review of Consumer Acceptability Testing Research, October 2021, and NERA Willingness to Pay for improvements to Dublin Airport Terminal 1, July 2014.

Executive SUMMARY

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Executive Summary

- Dublin Airport is a crucial enabler of growth in the Irish economy and needs to provide service quality appropriate for a national gateway.
  - Customers need an airport providing ease of service, so that they reliably and straightforwardly get to their destination.
  - Restoring resilience to airport operations is essential to provide this service - and to handle any further changes in demand.
- To restore high quality service, the passenger charge needs to reflect the efficient cost of recovery.
  - Dublin Airport cut costs and investment as its finances deteriorated in the pandemic.
  - Restoring service to the levels needed requires additional funding (both opex and capex), particularly to deal with surges in demand rather than gradual changes.
  - Customers expect additional steps to be taken so that the airport is clean and safe for them to use.
- Dublin Airport enters the review with the lowest airport charges in the industry.
  - Dublin Airport's aeronautical charges has ranked amongst the lowest of all relevant peer competitor airports.
  - Airport charges are a relatively small component of an airline's overall cost structure. Our proposed increase in airport charges for 2023-26 represents an increase in airline costs of around 4%, relative to 2019.
- Operating expenditure needs to take account of the current economic environment.
  - Current resources allow a minimum standard of service - but this is not what customers expect.
  - Wage inflation and staff shortages are increasing the efficient cost of driving airport recovery and a return to business-as-usual operations.
- The airport needs to be financeable - it cannot continue on the same basis as the last three years.
  - The cost of capital needs to reflect what is known about the current risk exposure facing the airport in particular through an appropriate asset beta.
  - The cost and revenue building blocks in the Commission's settlement must support resilient financeability of the airport.

- The building blocks in the draft decision deliver revenues and cash flows that collectively do not support airport financeability.
- The Commission's solution to advance future depreciation was rejected as a legitimate solution to solve financeability by the UK CMA. There is no legitimate justification for the Commission's approach.

➢ Customers rightly demand an efficient airport delivering the service they require, not a minimum cost service.

- Dublin Airport is not operating in steady state, business-as-usual, conditions.
- The efficient costs needed to support recovery and enable the airport to serve the rapid bounce back in passenger volumes cannot be determined by the standard regulatory approach.
- We are seeking to deliver a substantial step change in capacity and service in a short period, against a challenging economic climate.
- Customers have expressed a clear willingness to pay for improved service and reliability. We owe it to customers to deliver that, but we need to be funded appropriately to do so.

➢ Sustainability is in everyone's interest and therefore at the core of our plan.

- Dublin Airport has an ambitious plan to become a more sustainable operator and to meet Government environment objectives.
- Sustainability will be explicitly called out and be at the centre of the Commission's updated objectives.
- The Commission should make a determination that enables Dublin Airport to deliver on its plans.

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Dublin Airport's response CAR Draft Decision 2022

01 introduction

1. Introduction

1.1 Dublin Airport Submission

1.1.1 Dublin Airport welcomes this opportunity to make a submission in response to the 2022 Draft Decision on the Third Interim Review of the 2019 Determination which was published by the Commission for Aviation Regulation ("CAR" or "the Commission") on the 22nd July 2022.

1.1.2 In replying to this draft decision CP3/2022, Dublin Airport requests that the Commission also pays due regard to the company's Regulatory Proposition submitted on the 3rd May 2022.

1.2 Objectives for 2030

1.2.1 Dublin Airport's future strategy is based around plans to meet the high expectations of our airport users and stakeholders now and to secure our long-term viability by preparing appropriately for future needs. The key drivers of our strategy include network, customers, people, planet, and finances.

1.2.2 In implementing this strategy, we have a number of set goals for 2030:

- **We will have the most balanced network in Europe.** We believe that providing a quality air network is the first duty of the airport and a necessity for international travel, trade, and tourism. Ireland needs direct connections, robust schedules and an airline portfolio that offers choice to consumers and the benefits that competition brings to stimulate a market. A balanced network means the right balance of airline model, fleet, and reach/connectivity.
- **Support the Continued Development of Home-Based Carriers.** We aim to stimulate short haul traffic and facilitate the ongoing development of the Transatlantic Joint Venture. We also want to support the current based operation and aim to develop further growth from non-based units to minimise impact on capacity and facilitate introduction of 737MAX aircraft with additional seats and noise benefits.
- **Support Growth in Long Haul Markets.** For travel to the USA and Canada we aim to stimulate recovery and build frequency and year-round capacity into core US and Canadian hubs, building on the strength of Ireland as a 'safe' recovery market. We want to promote connectivity to other long-haul markets – ensure recovery of both frequency and capacity from European flag carriers, and Middle East operators to ensure hub connectivity is maintained for Asia, Australasia, Africa, and Latin American markets. Finally, we want to begin the process of rebuilding relationship with Asian carriers.
- **Provide effortless travel experiences & rewarding partnerships.** We are a people and service business. Experiences are at the core of everything that we do. We want to make travelling, buying, communicating, and contracting a positive and mutually beneficial experience.

- **Take the lead in sustainable transformation in national aviation.** We will take responsibility and commit to transformation in how we do our business regarding every facility, every process, every decision in order to achieve our sustainability targets.
- **Provide our employees with an exciting career, not just a job.** Our people are our greatest asset and must be a priority. With the aftermath of the pandemic and the competition for talent, the drive for potential employees to see long term value and purpose in our brand and the need for us to improve our own employee experience are key drivers within our strategy.

1.2.3 Key to achieving the above goals and maintaining Dublin Airport's resilience while continuing to meet the travelling publics expectations is a strategic price cap aligned with the 2022 Regulatory Proposition. It is crucial the Commission understands the direct implications of a lower price settlement in its final 2022 Interim Review Decision and how this is likely to ultimately prejudice the delivery of Dublin Airport's strategic goals.

1.2.4 The Commission's proposal does not enable Dublin Airport to proceed with its objectives for the following reasons:

- There is not appropriate reward commensurate with the risk that Dublin Airport faces through the regulatory model.
- The regulatory drive for efficiency and persistently lower charges does not effectively allow resilience in the operation.
- Insufficient funds to meet the service quality obligations.

1.2.5 This is because the Commission fails to recognise the context and macro challenges of this review, which are:

- The current macroeconomic outlook is uncertain.
- The airport is still recovering from the pandemic, and some assumptions need to be either temporarily (i.e. during the recovery period) or permanently different now.
- Investors, likewise, have adjusted their views, and this needs to be taken into account.

1.2.6 The Commission 's Draft Decision does not enable Dublin Airport to proceed with its objectives for the following reasons:

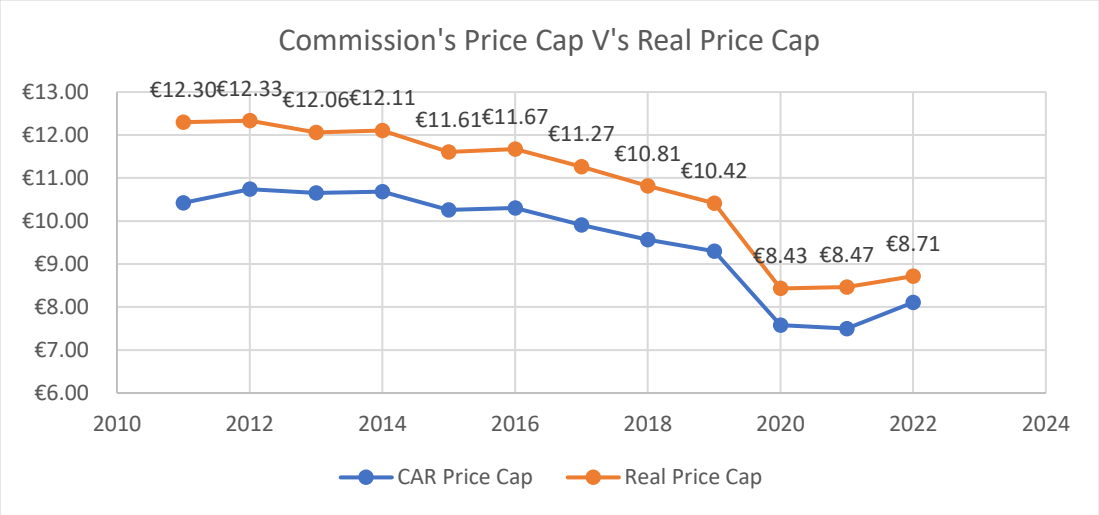
- The proposed reward does not compensate Dublin Airport for the risks it will face through the regulatory model making the airport unfinanceable.
- The regulator' drive for persistently lower charges conflates the notion of efficiency with the lowest possible price impairing the effectiveness and resilience of the airport's operation.
- Financial allowances and service quality conditions are not properly calibrated in essence the decision provides Insufficient funds to meet the service quality obligations.

1.2.7 Furthermore, the Commission's consistent drive to set charges as low as possible over the last 3 price control determinations has led to Dublin Airport charges being artificially low when compared to peers, effectively removing Dublin Airport's ability to run a resilient operation and not underperform its operational allowances. This downward spiral on charges is even

more out of touch with the economic reality of the airport when over the last 10 years Dublin Airport has invested c.€1.2bn and raised its service standards which has seen service quality targets increase by c.20%, both of which put upward pressure on charges.

1.2.8 Dublin Airport's charges are the lowest among comparator European airports and have consecutively fallen in real terms for the last decade. This is evidenced by the graph below.

- **FIGURE 1 DUBLIN AIRPORT PRICE CAP TRAJECTORY**



1.2.9 In addition, Dublin Airport's operational expenditure is below peers as evidenced in the detail provided in Appendix 1.

1.3 Context of Review on Dublin Airport

1.3.1 The current macroeconomic outlook is very uncertain and volatile due to political, economic and environmental factors. In light of these uncertainties, the Commission must provide Ireland's leading airport with a credible price path under the regulatory framework as we seek to drive our recovery and future development strategy to the benefit of passengers.

Key macroenvironmental considerations

1.3.2 The Commission's price decision for the period 2023-26 is taking place amid an unprecedented level of risk and volatility for the aviation industry. This is not only motivated by the uncertainty over how and when the industry will fully recover from COVID—19, as discussed in Chapter 4, but by a very challenging macroeconomic environment.

The following indicators describe the macroeconomic environment for the period 2023-26:

- GDP projected growth [Ireland, UK, EEUU and Europe]
- Interest rate [ECB, BoE, Federal Reserve]
- Inflation [Ireland]
- Economic pulse [Ireland]
- Aviation specific measure [Increased cost of fuel]
- Tight labour market, with low vacancies and high wage inflation [ideally some sector-specific - e.g. transport - stats rather than economy-wide]

1.3.3 Regulatory best practice demands that the regulator's decisions are grounded in the sector's specific conditions *and* the wider macroeconomic environment. This ensures that regulatory decisions are appropriately calibrated and made with due consideration of how foreseeable departures from the assumed economic conditions may affect the regulated company's ability to deliver the outcomes set by the regulator.

1.3.4 Against this negative economic outlook, the Commission adhering to regulatory best practice in its 2023-2026 price control decision is of fundamental importance to fulfilling its regulatory objectives. Arguably, it is more important than in any previous decisions taken by the Commission or by any other sector economic regulator for the following reasons:

1) The pro-cyclical nature of the aviation industry amplifies the likelihood of negative consequences to the airport, passengers, airlines and Ireland of a poorly calibrated price control decision.
2) The Commission's proposed regulatory framework[2] fully exposes Dublin Airport to passenger volume risk. Passenger volumes are primarily driven by wider economic conditions.
3) Dublin Airport's ability to deliver on the Commission's forecast of key operational building blocks (other than passenger volumes) would also be affected by external factors, outside of Dublin Airport's control. For example, outturn energy prices and/or construction inflation greater than the assumed level by the Commission.

1.3.5 Dublin Airport believes that the Commission should take the following steps to ensure that its price control decision delivers on its primary objectives and is robust to changes to the economic environment:

[2] Dublin Airport supports the Commission's proposed regulatory framework

1) As a matter of principle, the Commission should factor in the most up to date economic data as part of its decision-making process. This would include current economic forecast indicators, including (but not limited to) GDP, interest rates, inflation, energy prices and construction inflation.

2) The Commission should consider whether any of its current approaches need to be adapted to reflect the current uncertainty and volatility in the market (e.g. with respect to inflation indexation). Some approaches may have been appropriate in a stable / low inflation environment, but are not appropriate in the current macroeconomic environment.

3) The Commission should understand how departures from the assumed economic environment (i.e. its base case) would affect Dublin Airport's ability to deliver the price control determination. Furthermore, the Commission should consider the likelihood of potential departures from its base case. This is of particular importance for the passenger forecast determination.

4) Set a cost of capital that fully compensates Dublin Airport for the non-diversifiable risk. Asset beta should be estimated with reference to an appropriate set of comparator airports and taking full account of the impact that COVID-19 has had in airports' risks.

5) The Commission should set a financial viability assessment that:
   a) Targets a BBB+ credit rating metric levels[3], with appropriate headroom for each ratio. Headroom levels provided in other regulated sectors like energy and water should represent the bare minimum given the substantial differences with aviation. Other regulated sectors like water and energy are not pro-cyclical, in addition these sectors tend to be regulated on a revenue basis (ie. equivalent to full volume risk protection).
   b) Includes a full ranging sensitivity analysis. Particular importance should be placed in the impact that changes in interest rates could have on Dublin Airport's ability to meet targeted credit rating metrics.

Dublin Airport Market Dynamics

1.3.6 The COVID-19 pandemic brought about the most profound operational and financial challenges for global aviation in modern history. As the industry seeks to recover and adjust, we continue to face significant uncertainty and arduous market conditions. Dublin Airport believes that we must acknowledge the difficulties which arose and the burden which the regulated entity and its staff has endured on the back of the pandemic. Indeed, these

[3] FFO/ net debt and Net Debt/ EBITDA

difficulties were industry wide, with our key stakeholders, airline customers and the travelling public experiencing the same operational and financial challenges.

1.3.7 Fundamental to enabling the restoration of traffic and stability for the airport business is the pricing decision which emanates for the Commission under this 2022 Review. Dublin Airport believes it is crucial that the Commission not only reviews the regulated entity's building block allowances, but that proper consideration is given to broader market dynamics, including the behaviour of airlines as well as our peer competitor airports in Europe. COVID-19 has served as the structural change in the aviation market which has focused all parties on the impacts and application of pricing. Given this structural market shift, Dublin Airport is keen, that the Commission applies an appropriate price path for the period 2023-2026.

1.3.8 It should be acknowledged that the level of risk in the aviation Industry is exceptionally high as Dublin Airport faces a series of consecutive crises. We have been forced to deal with significant demand and capacity uncertainty/volatility, huge cost pressures across all inputs (CPI, raw material prices, energy costs, wage inflation and skills shortage), our sustainability challenges plus the increasingly negative geopolitical climate. As a result, investor risk appetite for aviation has been severely challenged and ultra-low airport charges cannot hold against the tidal waves of countervailing negative pressures.

1.3.9 Given the abovementioned factors, the Commission must recognise that the price path for Dublin Airport for the remainder of this decade needs to be significantly higher than the trajectory set in the 2019 Determination. Evidently action is required to address and rebase the price cap in the current operational reality. On this basis we are disappointed with the Commission's Draft Decision of an average price cap of €8.52 (€9.11). The price cap trajectory proposed by the Commission is wholly inadequate to fund the resilient operation and development of Dublin Airport over the period 2023-2026, for which the range of c. €13 that we proposed in our Regulatory Proposition would be required.

Introduction Chapter Summary:

- Dublin Airport's future strategy is based around plans to meet the high expectations of our airport users and stakeholders now and to secure our long-term viability by preparing appropriately for future needs.
- On this basis we have our clearly defined goals for 2030.
- The key to achieving the 2030 goals and maintaining Dublin Airport's resilience is a strategic price cap aligned with the 2022 Regulatory Proposition.
- Currently the Commission is not enabling Dublin Airport to proceed with its objectives for the following reasons:
  - There is not appropriate reward through the regulatory model
  - The regulatory drive for efficiency and persistently lower charges does not effectively allow resilience in the operation
  - Insufficient funds to meet the service quality obligations.
- In its final decision the Commission needs to take account of the current uncertain macroeconomic outlook is uncertain, changing investor priorities and how the airport is still recovering from the pandemic.

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02

Airport Charges Review

2. Airport Charges Review

2.1 Introduction

2.1.1 This chapter describes the interplay between the Commission's Decision on airport charges and the final ticket prices paid by consumers. Informing all stakeholders in a non-technical manner on these dynamics enhances transparency over the process which is ultimately in the interest of users.

2.1.2 Pricing data has been collated from a range of sources in order to show Dublin Airport's Aeronautical price comparisons for overall benchmarking and airfares. There is also consideration to the application of the price cap formula and some of the fundamental adjustments which apply. This is necessary as the price data and causal factors of price comparisons differ dependent on the analysis taken.

2.1.3 It is important to note that the application of the overall price cap and aeronautical charges is impacted by the regulatory Decision but also:

a) The airlines and industry players, in ensuring that least cost in their actions are passed on through pricing to consumers

b) The Department of Transport through setting National Aviation Policy and strategic priorities, and

c) Industry and consumer representative bodies who ensure the travelling public are informed of the downward pricing pressure applied by the Commission and impacts to service quality delivery.

2.1.4 The chapter also seeks to address key fundamental inputs used to derive the overall price cap formula. Namely, the application of the inflation and the treatment of over/under recovery.

2.2 Dublin Airport Competitive Position

2.2.1 Dublin Airport is one of the cheapest airports in Europe having one of the lowest aeronautical pricing levels of comparable airports. Under Dublin Airport's proposals, as detailed in the regulatory proposition, its supporting appendices and addendum, the airport will remain among the lowest in Europe in the next regulatory period.

2.2.2 In the wake of the pandemic and in light of the required long-term development of the airport, there is an urgent need to set charges that enable Dublin Airport to recover efficiently invested costs, maintain the financeability of the airport and meet the needs of current and future users.

2.2.3 It is important that the Commission recognises the increasingly competitive nature of the airport sector in this decision-making process. In the past airports were considered to be natural monopolies. Over time almost all UK airports (except for Heathrow) have been

deregulated or regulatory arrangement have become significantly less intrusive. It is therefore clear that airports must compete with each other for passengers and airlines which have significantly more choice than in the past.

2.2.4 The result is a competitive and dynamic market. Airports themselves have become more commercially focused[4]. Given the level of competitiveness in the airport market, it would not be in the interest of Dublin Airport to set prices that did not reflect the efficient level of service provision (i.e. the competitive level) since it would undermine its competitive position and potentially lose customers.

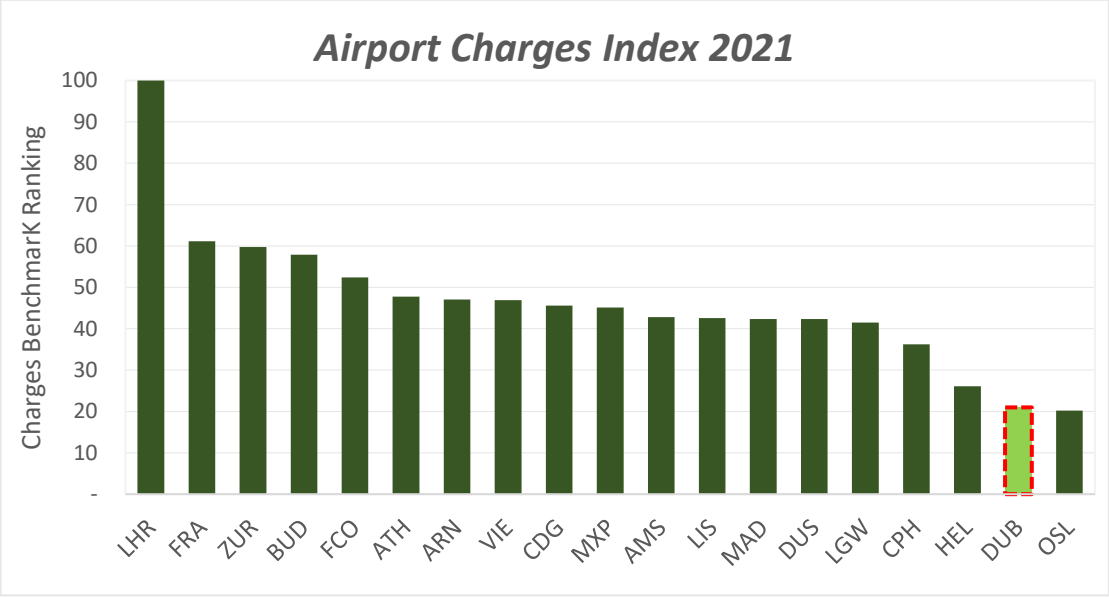
2.3 Airport Charges Benchmark

2.3.1 Comparative benchmarks of airport charges have shown that Dublin Airport is one of the most competitive of the larger airports in Europe in relation to airport charges. Following the 2019 Determination, the Commission implemented a 20% charging reduction in 2020, severely curtailing our future earnings and leaving us with no headroom for downside risks. Dublin Airport's price levels have been declining in real terms, year on year since 2010.

2.3.2 To demonstrate an impartial competitive ranking of Dublin Airport when compared to similar peer airports in Europe, a sample comparative range and data has been drawn from the independent Jacobs UK review of Airport Charges 2021. This is the most relevant and widely used benchmark of the industry.

2.3.3 Year on year comparatives demonstrate that Dublin Airport's charges ranking has decreased considerably when analysed against similar peer European airports, with Dublin ranked as one of the most competitive in the region.

- **FIGURE 2.1 AIRPORT CHARGES INDEX 2021**



(Source: Jacobs UK Review of Airport Charges 2021)

[4] Oxera, 2017. The Continuing Development of airport competition in Europe. report for ACI Europe.

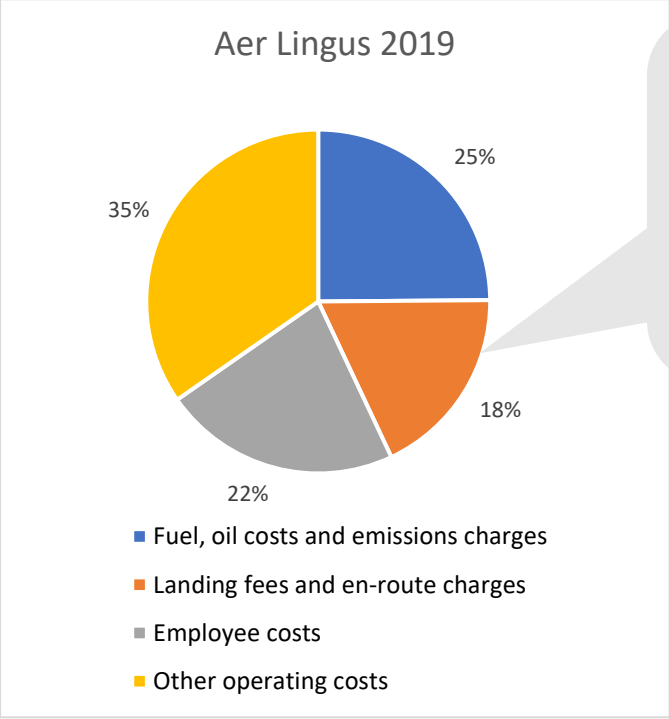
2.4 Airport charges as a % of airline costs and ticket prices

2.4.1 Airport charges are an important element of an airlines' cost base, and when combined with other airlines' cost increases it adds to the upward pressure on airline costs. However, when viewed alongside other cost increases, it seems unreasonable to single out our airport charges as driving negative outcomes in the sector, especially when our charges are regulated by an independent regulator and designed to be cost-reflective, thereby representing the 'fair' economic price to use the airport. We expand on these points below.

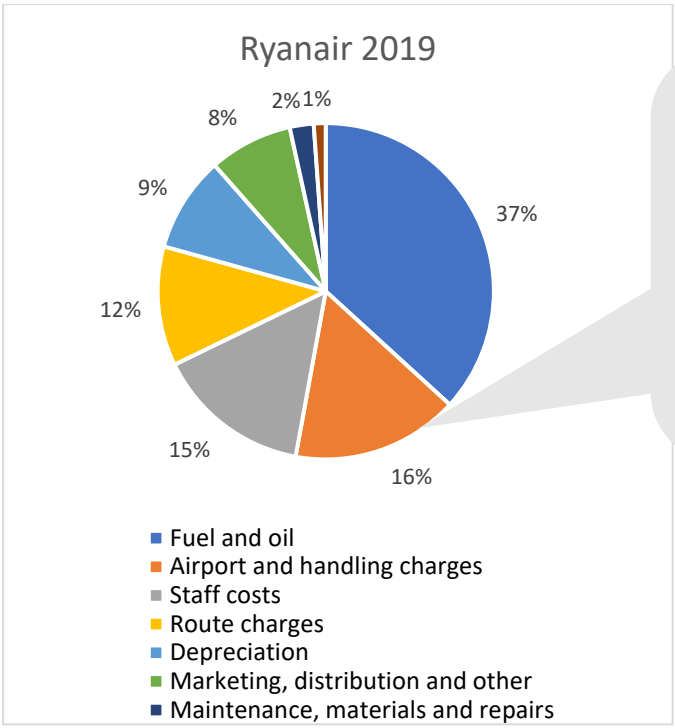
Airport charges are a relatively small component of an airline's overall cost structure

2.4.2 It is worth noting that airport charges at Dublin Airport are just one cost item in an airline's overall cost structure, alongside other cost items such as fuel, labour, and aircraft financing costs, as well as airport charges at other airports. To put our charges into perspective, the charts below report the breakdown of Aer Lingus' and Ryanair's operating costs in 2019 (i.e. pre-pandemic, to give a sense of business-as-usual conditions).

- **FIGURE 2.2 DUBLIN AIRPORT CHARGES AS A % OF AIRLINE OPERATING COSTS**



"Landing fees and en route charges" represented 18% of Aer Lingus' operating costs in 2019. Note that this also includes air traffic control charges, as well as airport charges at other airports. Therefore, our charges represent less than half of this amount.



"Airport and handling charges" represented 16% of Ryanair's operating costs in 2019. Note that this also includes ground handling charges, as well as airport charges at other airports. Therefore, our charges represent less than half of this amount.

(Source: Analysis of airline annual reports)

2.4.3 The evidence illustrates that in 2019 our airport charges represented at most 8%-9% of airlines' operating costs.[5] Our proposed charge for 2023-26 of €13.83 per passenger on average over the period represents a 49% increase since the start of the pandemic (up from €9.30 per passenger in 2019).

2.4.4 While this is a relatively large increase, we would stress that our charges are supported by evidence and these reflect the efficient allowance for a reliable operation and the service quality expected by consumers.

2.4.5 Also, when expressed as a proportion of airline operating costs, our proposed increase in airport charges equates to an increase in airline costs of around 4%, relative to 2019. We would flag that this increase is dwarfed by the increase in fuel prices observed over the same period:

- Fuel: As shown above, prior to the pandemic, fuel costs represented around 25% of Aer Lingus' operating costs, and 37% of Ryanair's. Since 2019, there has been a significant

[5] For Aer Lingus, 'landing fees and en route charges' represented around 18% of total operating costs in 2019. However, we note that this cost item also includes costs for air traffic control services, which are not provided by daa, and it also includes airport charges at all the other airports where Aer Lingus operates (e.g. when Aer Lingus flies between Dublin and Heathrow it pays airport charges at both ends). Therefore, we conservatively estimate that our charges represent less than half of this amount, at around 9% of total operating costs.

For Ryanair, "airport and handling charges" represented around 16% of total operating costs in 2019. However, this includes groundhandling charges, which are not provided by daa, as well as airport charges at other airports. Therefore, our charges likely represent less than half of this amount, at around 8% of total operating costs.

increase in fuel costs. In 2019, a metric tonne of jet fuel was trading for about €562 in Europe. By August 2022, a metric tonne of jet fuel was trading for €1,117 – i.e. a 99% increase.[6] There have been various media reports with comments from airlines suggesting that the increase will inevitably impact on ticket prices.[7]

2.4.6 The following table puts our proposed increase in airport charges at Dublin Airport in perspective alongside these other cost increases.

- **TABLE 2.1 THE INCREASE IN AIRPORT CHARGES AS % OF AIRLINE COSTS**

		% of 2019 costs	% increase 2019-2022	% increase in 2019 cost base
Aer Lingus	Airport charges at Dublin Airport	9%	49%	4.4%
	Fuel	25%	99%	24.6%
Ryanair	Airport charges at Dublin Airport	8%	49%	3.9%
	Fuel	37%	99%	36.4%

2.4.7 Similarly, the table below examines the potential impact on ticket prices – which makes the implicit assumption that higher airline costs would be passed through in full to passengers in the form of higher ticket prices. We have expressed the proposed increase in our airport charges as a percentage of the average ticket price for a return journey at Dublin Airport – focusing on short haul and long haul separately (taking an average across all airlines). As can be seen, for a return flight to a long-haul destination, the increase equates to as little as a 1% increase in price.

- **TABLE 2.2 THE INCREASE IN AIRPORT CHARGES AS % OF TICKET PRICE**

	Return ticket*	Proposed increase in charges**	% increase in ticket price
Short haul - average return	€ 147	€ 9.06	6.2%
Long haul - average return	€ 719	€ 9.06	1.3%

(Source: OAG data for June 2022)

[6] Source: Bloomberg, European Jet FOB Rotterdam Barge Spot.

[7] For instance, Michael O'Leary has commented that higher oil prices would result in Ryanair's average fare (across Europe as a whole) rising from about €40 to €50 over the next five years. https://www.theguardian.com/business/2022/aug/11/ryanair-boss-blames-brexit-for-airport-chaos-and-says-era-of-10-euro-airfares-over-michael-oleary?utm_term=Autofeed&CMP=twt_b-gdnnews&utm_medium=Social&utm_source=Twitter

**Airport charges are proposed to increase from €9.30 per passenger in 2019 to €13.83 per passenger on average for 2023-26. This equates to an increase of €4.53 per passenger, or €9.06 per return trip (i.e. x2)

2.4.8 This is not to suggest that the increase in airport charges is not significant. However, when viewed alongside other cost increases, it seems unreasonable to single out our airport charges as driving negative outcomes in the sector, especially when our charges are regulated by an independent regulator and designed to be cost-reflective, thereby representing the 'fair' economic price to use the airport. Also, as we levy the same charges to all airlines, they do not represent a source of inter-airline rivalry at Dublin Airport, and airlines should be able to pass through the increase in full to passengers.

2.5 Dublin Airport Review of Price Cap Formula Application

2.5.1 Seminal to the Airport Charges review is the application of the Commission's price cap formula as part of the regulatory Decision. Fundamental adjustments are applied to the price cap traditionally in the form of inflation adjustments, management of over/under recovery, service quality bonuses and capital expenditure triggers. Given the current macro environment any discussion on charges must be informed by analysis of inflation and the over-under recovery position.

Treatment of inflation in the price cap

2.5.2 As the Commission states in its Draft Decision, the intent of its approach to regulating Dublin Airport is that it should not be exposed to general inflation risk, and that it is not remunerated for taking on such a risk.

> *The price cap is set in real prices, which means that it excludes inflation. All figures in this document are in February 2022 prices, unless stated otherwise. The price cap will be updated each year to reflect actual inflation in the period. This means that Dublin Airport* ***is protected from general inflation risk, which is particularly relevant in the current high and unpredictable inflation environment****.*[8]

2.5.3 As the Commission notes, such protection is particularly relevant in the current macroeconomic environment. This protection was fundamental to a number of decisions made as part of CEPA/Tailor Airey's review of efficient OPEX, such as exposure to energy prices.

2.5.4 However, ensuring that companies are protected from outturn inflation risk within a regime in which nominal charges are set ex-ante requires careful regulatory design. Economic regulators have broadly taken two approaches to ensure this protection:

[8] CAR (2022), 'Draft Decision on an Interim Review of the 2019 Determination in relation to 2023 to 2026', 22 July, p. 2., accessed on 14 September 2022 at: https://www.aviationreg.ie/_fileupload/2023%20Interim%20Review/Draft%20Decision_Final.pdf

- Basing the inflation assumptions that underpin the nominal charges cap on a forecast for the year, with an ex-post true-up mechanism to ensure that the airport does not benefit or lose out when outturn inflation deviates from the forecast level;
- Applying outturn inflation with a yearly lag—for example basing the allowed revenue yield cap in 2023 on outturn price inflation in 2022.

2.5.5 While these approaches are likely to yield similar outcomes in a stable, low-inflation environment, they may yield materially different outcomes when inflation is high and volatile, as it is currently.

The Civil Aviation Authority's approach

2.5.6 Prior to its most recent regulatory settlement, the UK Civil Aviation Authority (CAA) applied the following approach to index inflation for Heathrow over the control period. This approach is broadly analogous to the approach taken by the Commission.

2.5.7 This was reflected in the 'K-factor' adjustment mechanism set out in Heathrow's License, which allowed for a 2-year adjustment to reflect over- or under- recovery of revenues and assumed that this would be based on the *previous* year's inflation level.

2.5.8 However, in its Final Determination for H7, the CAA changed its approach to accounting for inflation. The grounds for doing so were based on the same intent set out in the Commission's Draft Decision—i.e. to ensure that the airport is protected from general inflation risk.

2.5.9 The CAA sought to address this by changing the airport's license condition as follows:

> *"We propose to **eliminate any scope for mismatch** by setting the reference dates in the price control licence condition to calendar year inflation. This means that HAL's entitlement to inflation indexation for the year 2023 will be **set in accordance with out-turn CPI inflation in 2023 compared to 2022.** Similarly, HAL's entitlement to inflation indexation for the year 2024 will be determined by reference to out-turn CPI inflation in 2024 compared to 2023…*
>
> *….We would therefore expect HAL to make **use of an up-to-date and publicly available forecast of inflation** (such as the most recently published OBR inflation forecast) when calculating charges and that **this would be an appropriate way for HAL to seek to comply with its obligations under the price control.***
> *...We further note that the K-factor term in the price control provides for any over or under-forecasting of inflation **to be trued up in the calculation of the price cap for a given regulatory year, with a lag of two years"**…*[9]

[9] CAA, H7 Licence modification consultation, p.132: https://publicapps.caa.co.uk/docs/33/CAP2365D%20H7%20Proposals%20Section%203-kb.pdf

2.5.10 In addition to outlining Heathrow's entitlement to inflation, and that the use of publicly available inflation forecasts would be an appropriate approach for Heathrow to take in seeking to comply with its price cap obligations, the CAA also adjusted the 'K-factor' mechanism to explicitly account for over- or under- recovery of inflation.

Dublin Airport's proposed approach to indexation and inflation for Final Decision

2.5.11 There are a number of options for adjusting the revenue yield cap to ensure that within-year inflation is accurately reflected in the charges that Dublin Airport can recover from its users.

2.5.12 The approach that is most transparent, easy to implement and consistent with regulatory precedent would be to adopt an approach aligned to that of the CAA for Heathrow. We consider that in this approach, we would use an inflation forecast for the year, with a true-up mechanism to recover any over- or under- collection.

2.5.13 The true- up would be a standalone adjustment and input to the price formula, similar to the K-factor application. While this approach is particularly important in the current high inflationary environment, it is also a more appropriate approach in general.

Over/under recovery (K-factor) application

2.5.14 As detailed in the Dublin Airport Regulatory Proposition submitted in May 2022, we request the continued application of the K factor term in the regulatory formula to allow for a limited carry over of under recovered revenues against the annual price cap. The K-factor application is necessary due to the high level of uncertainty in the market.

2.5.15 However, given the current market instability, the level of the K-factor under-recovery cap of 5% does not provide Dublin Airport with enough confidence to optimally design and implement its pricing policy. Leaving this unchanged may be detrimental for users and passengers, and lead to potentially sub-optimal pricing decisions. Therefore, Dublin Airport requests that the cap is increased from 5% to a minimum of 10% for the period 2023–26.

2.5.16 The structure of airport charges is more complex than the yield per passenger identified by the price cap and requires a number of assumptions to be made when forecasting revenues. Contrary to some other regulated sectors, which follow a more linear approach with regard to charging,[10] airport charges are often differentiated on the basis of the season and according to the multitude of services offered (e.g. passenger, aircraft, parking) which reflect different underlying drivers and forecasting complexities. The current uncertainty characterising the aviation industry, the difficulties in estimating traffic reliably and the changes in passengers' behaviour are all elements that exacerbate the challenges faced by Dublin Airport in setting accurate charges. As such, Dublin Airport requests a greater degree of flexibility to be granted through the K-factor.

[10] For example, regulated water and energy network tariffs are typically set as a combination of a fixed charge per customer/household and a charge per unit of consumption.

2.5.17 The regulatory model ensures that, should Dublin Airport collect more than permitted, it rebates users for the amount exceeding the maximum permitted yield per passenger (with no cap) within 90 days of the end of the year. Dublin Airport agrees with this approach, which forms the basis of the price cap model.

2.5.18 With no risk-sharing mechanism in place, in the presence of imperfect pricing, the k-factor is the only means to ensure that Dublin Airport receives per-passenger revenues that are aligned with the regulatory settlement. Considering that the k-factor adjustments are neutral in net present value terms, increasing the level of the cap for reprofiling revenues (i.e. to a minimum of 10%) would not have a financial impact on users and passengers, while providing Dublin Airport with greater confidence in the design and implementation of its pricing policy and mitigating the effect described above.

2.5.19 In this regard, it is worth noting that the CAA applies a correction factor covering the total of the over- or under-recovery of the permitted yield for Heathrow Airport.[11]

[11] Civil Aviation Authority (2014), 'Economic regulation at Heathrow from April 2014: Notice granting the licence', February, p. 178, available at https://publicapps.caa.co.uk/modalapplication.aspx?appid=11&mode=detail&id=6072 (last accessed 14/09/2022).

Airport Charges Chapter Summary:

- Dublin Airport's aeronautical charges has ranked amongst the lowest of all relevant peer competitor airports.
- Airport charges are a relatively small component of an airline's overall cost structure. Our proposed increase in airport charges for 2023-26 represents an increase in airline costs of around 4%, relative to 2019.
- Over the same period, fuel prices have doubled. Given that fuel typically represents around 30% of airline costs, this can be expected to increase airline costs by an additional 30% – significantly higher than the impact of our proposed increase in airport charges.
- When expressed as a percentage of ticket prices, the proposed increase in charges represents as little as 1% for the average long haul return flight at Dublin Airport.
- Given the current macroenvironment, we request that inflationary impacts be best managed through the use of an inflation forecast for the year, with a true-up mechanism to recover any over- or under- collection.
- Dublin Airport requests an increased application of the K factor from 5% to a minimum of 10% for 2023-26.
- Our key ask from this regulatory review is to find an appropriate price path that not only provides an efficient level of airport charges, but that will also allow Dublin Airport sustain operations and secure its financial viability in the interest of both the airport and our airport users.

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Policy & Legal Review

3. Policy and Legal Review

3.1 Policy Considerations

3.1.1 In seeking to comply with our statutory requirements and maintain the appropriate strategic development, Dublin Airport has also been guided by the National Aviation Policy[12] ("NAP"), which was published by the Department for Transport, Tourism and Sport ("DTTAS") in 2015. Among the goals outlined in the NAP are:

- Creating conditions to encourage the development of new routes and services, particularly to new and emerging markets
- Ensuring a high level of competition among airlines operating in the Irish market
- Optimising the operation of the Irish airport network to ensure maximum connectivity to the rest of the world.

3.2 Broader Policy – Critical Importance of Aviation in Ireland

3.2.1 As a small, open island economy, Ireland is crucially dependent on its air links to facilitate and grow its economy. Dublin Airport therefore plays a vital role as a strategic enabler for business growth and economic development and essential for sectors including export/import trade, technology, and tourism.

3.2.2 Dublin Airport also plays a central role in supporting the social fabric and national wellbeing of the country, enabling residents to make their living or enhance their lives by travelling overseas, keeping families and friends connected, bringing tourists on to the island and in providing safe and efficient routes for personal, medical, and humanitarian travel.

3.2.3 Dublin Airport's national strategic role as described in policy is to deliver high quality international connectivity for Ireland and to enable us to maintain and grow our strong position as an aviation hub in Europe. This requires appropriate investment in assets such as the new runway but also in the wider campus, improving public transport access and connections from the road network from the west and north. In the longer term, rail access via connections to the wider national rail network will be considered and is an important development as we move towards sustainable mobility. As we look ahead for the next five years, we are also mindful of the shortness of such a time horizon for an organisation that must plan, design, and deliver 50-year assets, some of which have delivery plans that span multiples of this current window. The work we do over the next five years is essential in order to progress us towards a long-term airport vision, as defined by our proposition and master planning activity. If this work is not done in time it will lead to significant delays in delivery and essential infrastructure not being available when required – a legacy no one wants.

[12] DTTAS, National Aviation Policy, September 2015.

3.3 Legislative and Policy Consideration

Assessment of options under Section 5.4 of Commission's Draft Decision

3.3.1 We have considered the various scenarios presented by the Commission under Section 5.4 of the 2022 Draft Decision with respect to how to implement a Determination, depending on when the Air Navigation & Transport Bill 2020 (the "ANTB") is enacted. Our view is that there is a legal basis for all of the options presented under Section 5.4 of the Draft Decision, such that all options may be appropriate depending on the particular circumstances which materialise. We welcome the conclusion that, in any event, any new Determination will be consistent with the clarified statutory objectives under the ANTB given that sustainability is already implicit in the current legislative framework, including in the objective regarding the interests of current and prospective users of Dublin Airport.

3.3.2 We make the following more detailed points regarding why there is a legal basis for all options presented under Section 5.4, and any of them may be appropriate depending on the circumstances, just for the purposes of completeness.

3.3.3 As regards the options which involve a Determination being made immediately once the ANTB is enacted, it is very clear that there is a legal basis for doing so under the ANTB and in particular it is very clear that the regulator can rely on analysis and consultation concluded prior to enactment of the ANTB in making a new Determination under the ANTB.

3.3.4 As regards the options which involve a Determination being made prior to the ANTB being enacted, it is also very clear that there is a legal basis for same. In particular, it is clear that the circumstances satisfy the legal standard under Section 32 (14) of the 2001 Act which details the circumstances in which the Commission may carry out a review of a settled determination. Section 32 (14) of the 2001 Act makes clear that the Commission is entitled by way of "its own initiative", or "at the request of an airport authority or user concerned in respect of the determination" to initiate a review (and subsequently amend, where necessary) of a determination if it considers that there "are substantial grounds for so doing". The Commission has cited the outbreak of the COVID-19 pandemic and the knock-on depletion of passenger numbers by 75% in 2020 and 2021 (when compared with 2019 passenger numbers) as the catalyst behind the initiation of an interim review. It is clear that the long-term, unprecedented impact that the C-19 pandemic is having on the aviation industry constitutes 'substantial grounds' under Section 32 (14) of the 2001 Act. We make this point for completeness as we would regard it as inconceivable to suggest otherwise given the volatility experienced.

3.3.5 We acknowledge that discretion rests with the Commission in respect of which option is chosen for implementation of a Final Determination. In doing so, the Commission must act in line with the relevant circumstances at the time and the relevant legal principles, including notably the following:

- *Legal certainty* – stakeholders including daa are entitled to legal certainty and closure of the ongoing regulatory review process, noting that the Commission and stakeholders including daa have expended significant time and cost in partaking in the current process and stand to suffer damage through potential uncertainty; and

- *Evidence based regulation* – the Commission is under an obligation to ensure that price regulation / any Final Determination is based on evidence which is reasonably up-to-date.

3.3.6 It would appear to us that the above principles may dictate that there will be a certain future point at which a Final Determination must be issued which provides certainty and is based on up-to-date data, regardless of whether or not the ANTB has been enacted by then.

3.3.7 The comments made in this section relate to the various scenarios put forward by the Commission in the Draft Decision at Section 5.4, and do not alter the Commission's ongoing obligations to conduct and conclude the decision making process in accordance with all the relevant legal requirements including to have regard to materially relevant considerations. We have carried out a detailed review of the Draft Decision and set out in detail in this document where we have concerns and how they can be addressed in order to ensure the Commission is complying with its obligations.

3.4 Statutory Obligations of the Commission and Dublin Airport

3.4.1 The key statutory objectives and considerations are summarised below.

3.4.2 The Aviation Regulation Act 2001 Act (as amended) (the '2001 Act') sets out the regulatory objectives to be met by the Commission in setting airport charges. Section 33(1) of the 2001 Act provides that:
"*In making a determination, the objectives of the Commission are as follows-:*

> *(a) to facilitate the efficient economic development and operation of Dublin Airport which meet the requirements of current and prospective users of Dublin Airport".*
>
> *(b) to protect the reasonable interests of current and prospective users of Dublin Airport in relation to Dublin Airport"; and*
>
> *(c) to enable daa to operate and develop Dublin Airport in a sustainable and financially viable manner."*

The Commission's amended Statutory Objectives (under the Bill)

3.4.3 We note that Section 96 of the Bill revises the Commission's statutory objectives under Section 33 of the 2001 Act such that in making a determination, the Commission's principal objective shall be *"to protect and promote the reasonable interests of current and prospective*

users of Dublin Airport". In addition to this provision, the Commission shall seek to adhere to the following:

> *"(a) promote safety and security at Dublin Airport;*
>
> *(b) facilitate the efficient and economic development and operation of Dublin Airport;*
>
> *(c) promote high-quality and cost-effective airport services at Dublin Airport; and*
>
> *(d) take account of the policies of the Government on aviation, climate change and sustainable development".*

daa's Statutory Objectives

3.4.4 Dublin Airport must operate in accordance with a number of statutory obligations relating to Dublin Airport under both the Air Navigation and Transport (Amendment) Act 1998 (the '1998 Act'), and the State Airports Act 2004 (the '2004 Act').

3.4.5 One of the principal objects of Dublin Airport as set out in section 8 of the 2004 Act is to "*manage, operate and develop" and "ensure the provision of such services and facilities as are, in the opinion of the company, necessary for the operation, maintenance and development of its airports*...". The principal objectives of Dublin Airport are also set out in section 23(1) of the 1998 Act. Section 23 provides, inter alia that the principal objects are "*to take all proper measures for the safety, security, management, operation and development* [of Dublin Airport] "*to promote investment at its airports*". Section 23(3) provides "*the company shall have the power to do anything which appears to it to be requisite, advantageous or incidental to, or which appears to it to facilitate, either directly or indirectly, the performance by it of its functions as specified in this Act or in its memorandum of association…"*

Considerations:

3.4.6 Our key ask from this regulatory review is to find an appropriate price path that not only provides an efficient level of airport charges, but that will also allow Dublin airport sustain operations and secure its financial viability in the interest of both the airport and our airport users. The Commission's statutory objectives are enabled to facilitate and coalesce with daa's statutory objectives, and deliver our key ask which is for the benefit of all users of the Airport and the Irish economy.

3.5 Sustainability Obligations

Climate and Low Carbon Development Act

3.5.1 In July 2021 the Climate Action and Low Carbon Development (Amendment) Act 2021 was signed into law. This Act establishes the following national climate objective:
"The State shall, so as to reduce the extent of further global warming, pursue and achieve, by no later than the end of the year 2050, the transition to a climate resilient, biodiversity rich, environmentally sustainable and climate neutral economy."

3.5.2 The Act provides that the first two five-year carbon budgets should equate to a total reduction of 51% over the period to 2030, relative to a baseline of 2018. While that overall target has not yet been disaggregated into sectoral targets, it is understood that the transport sector will be required to achieve this 51% reduction in full.

3.5.3 This is a highly significant and challenging target, which will fundamentally guide and direct transport and infrastructure provision and use in Ireland over the next decade. Achieving this target will require a major transformation with a focus on increasing sustainable infrastructure and travel within the State.

Fit for 55

3.5.4 The competitive European airport market is not only based in economic principles but more recently it has become focused on sustainable consumer choices. Sustainability clearly needs to be at the core of Dublin Airport's operations. The collective challenge is how we bring this to life in a meaningful and credible way for our passengers and stakeholders.

3.5.5 As part of the European Green Deal, with the European Climate Law, the EU has set itself a binding target of achieving climate neutrality by 2050. This requires current greenhouse gas emission levels to drop substantially in the next decades. As an intermediate step towards climate neutrality, the EU has raised its 2030 climate ambition, committing to cutting emissions by at least 55% by 2030.

Policy and Legal Chapter Summary:

- Dublin Airport plays a vital role as a strategic enabler for business growth and economic development in Ireland.
- Dublin Airport's national strategic role is to deliver high quality international connectivity for Ireland and to enable our strong position as an aviation hub in Europe. This requires adequate investment in airport infrastructure.
- Dublin Airport has considered the various options in respect to how to the Commission may implement a Determination, depending on when the Air Navigation & Transport Bill 2020 (the "ANTB") is enacted, and we believe that there is a legal basis for all of the options presented.
- Sustainability needs to be at the core of Dublin Airport's operations going forward.

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Passenger Forecast

4. Passenger Forecast

4.1 Overview

4.1.1 The Commission have proposed that the forecast for the next four years will grow to 35.2 million in 2026, which is an incremental 10 million passengers by 2026 compared to their projection for 2022. When considering the risks in delivering the traffic over the regulatory period, coupled with the aircraft growth forecasts, Dublin Airport do not believe that this target is realistic. While the Commission have commented that they considered market risks in the 2022 baseline, we do not believe that the risks have been considered for the period 2023-2026, particularly in the period 2025-2026 due to the return to the econometric approach, which uses the pre-covid elasticity. The risks outlined have only become more pronounced in recent months, and include:

- Cost of fuel and yield pressure
- Inflation / cost of living
- Eastern European crisis
- COVID-19 resurgence
- Capacity issues and constraints
- Business travel
- Supply Chains

Commission's Methodology

4.1.2 The methodology that the Commission propose is one which may be appropriate if the right variables are incorporated. We also have concerns that there is not sufficient transparency in the Commission's approach.

4.1.3 Nevertheless, as outlined above, the downside risks are becoming more prevalent, the latest ACI Europe forecast cannot be used to track traffic in Dublin Airport and the airline forecasts have not been properly considered by the Commission.

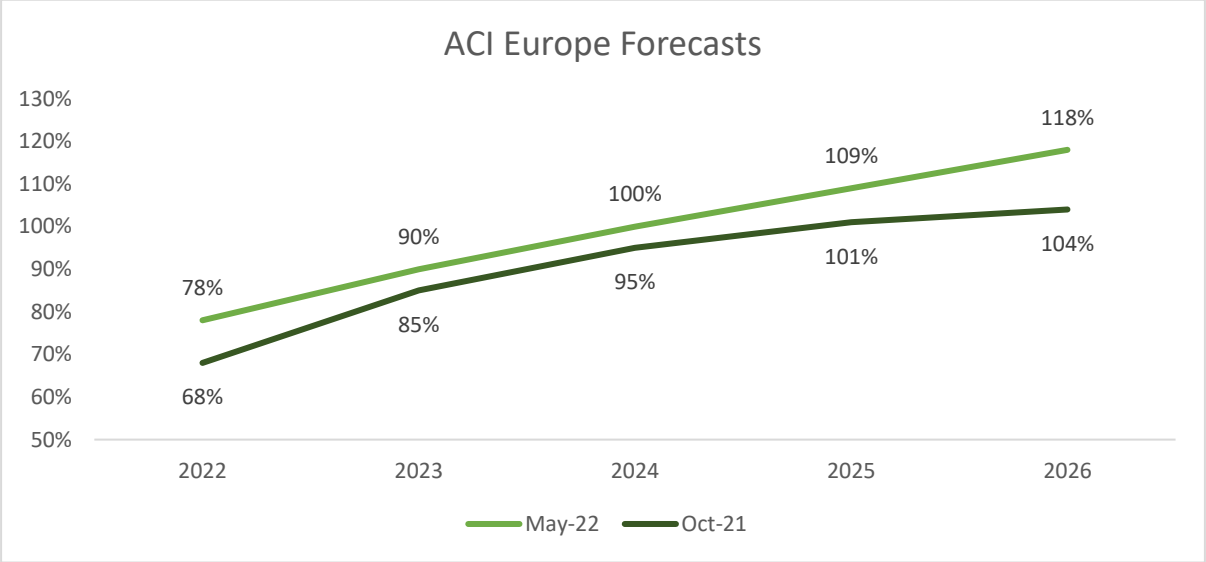
4.1.4 While the bottom-up approach for 2023 can give an indication of the potential range of traffic, we believe that the Commission's position within such range is too optimistic and does not consider the specific circumstances of Dublin Airport.

The use of ACI Europe Forecast

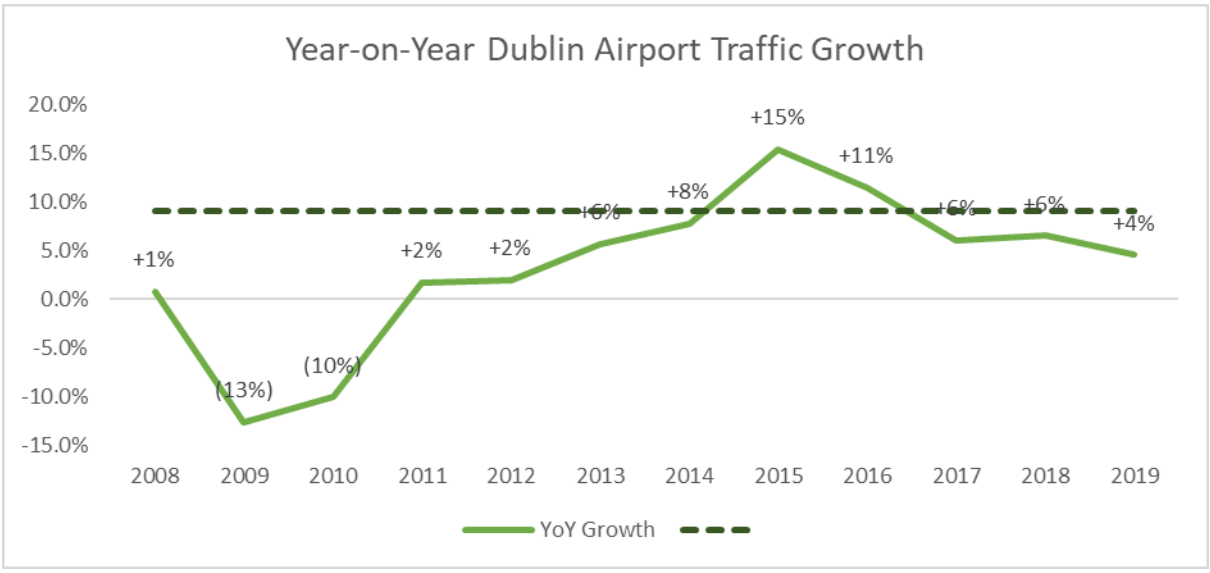
4.1.5 While both Dublin Airport and the Commission considered the ACI Europe forecast in the regulatory proposition / draft determination, there has been a significant change in the forecast since Dublin Airport used it as a guide for its forecast. The October 2021 version of the forecast had traffic reaching [redacted]

4.1.6 However, the forecast for 2026 has increased by [redacted] and now predicts traffic will reach [redacted]. While this may be a realistic target when taking all of the European airports into consideration, i.e., mature and emerging markets combined, it is not an appropriate forecast for Dublin Airport specifically.

4.1.7 Dublin Airport do not consider it plausible that the growth suggested by the ACI forecast for the last two years of the control period is plausible. Achieving such level of growth would mean for Dublin Airport to be just under 39 million passengers by 2026. Dublin Airport believe this is unrealistic as it would plot the airport traffic close to pre-covid assumptions of 2026 traffic. Dublin Airport would also have infrastructure issues with achieving this level of passengers by 2026 due to the deficit in contact stands, gates and security processing capability.



4.1.8 Dublin Airport have only had growth above 9% for 2 years since 2008 prior to the pandemic (2015 & 2016). Following that, growth slowed as there were fewer market opportunities.



4.1.9 [redacted]

[redacted]

4.1.10 [redacted]

4.1.11 [redacted]

4.1.12 As of the time of writing, Dublin Airport have not had any announcements from current or potential customers on additional capacity / operations for 2023.

4.2 Forecast Methodology

4.2.1 Dublin Airport would like to see more transparency on the forecast for 2024 / 2025 as the Commission have indicated that the forecast is positioned within the range of indications provided by the airlines. [redacted]

4.2.2 It is noted that the Commission reverts to the 2019 Determination methodology using the GDP based model. Dublin Airport believe that, as movements will most likely be back to 2019 levels by 2025, if the Commission is to continue its approach, it is prudent to apply this methodology from 2025.

4.2.3 Dublin Airport have argued previously (2019 determination) that there is merit in applying some of the other methodologies and forecasts considered by the Commission. Specifically, Dublin Airport believe that using a blended GDP becomes more appropriate when it is predicted that there will be a recession in the UK and possibly in some continental European states. Only considering a strongly performing Irish economy is flawed when 48% of all passengers are non-Irish (2019 statistic) and possibly overestimating the total amount of passengers forecasted for the regulatory period.

4.2.4 It is noted that, in 7.93, the Commission say that cancelled flights are "*likely depressing passenger demand"*. However, we have seen load factors on certain routes higher than 2019 during the peak, which is being inflated by these cancellations. Therefore, the true underlying demand still has question marks surrounding it due to this and whether the Summer 2022 demand is pent-up.

4.2.5 It should be noted, and considered in the forecast, that, Dublin Airport's 2022 traffic is inflated due to the €90 million government support allowing airlines to operate at a significant discount on charges. These will revert to non-discounted passenger charge in 2023.

4.2.6 Any forecast for traffic in Dublin Airport should not be unconstrained due to the capacity *constraints* that Dublin Airport have prior to the delivery of infrastructure. In Summer 2022, there was no availability in overnight contact stands in the airport.

4.2.7 Dublin Airport believe that the Commission's forecast is a very optimistic case, which only partially reflects the views of industry stakeholders. Considering the exceptionally high volatility currently in the market, along with the yet unknown full pandemic recovery, we believe it is prudent to adjust this downwards.

4.3 Dublin Airport's Proposed Forecast 2023 – 2026

Update to Dublin Airport Forecast

[redacted] Dublin Airport's previous forecast was completed in Q1 2022, while there were still many unknowns for the rest of 2022. Summer 2022 has turned out to be more positive than had initially been forecasted. Therefore, Dublin Airport are increasing the 2022 forecast from [redacted]

4.3.2 Dublin Airport's methodology to use a lower and upper bound of load factor for their forecasting model had shown that the lower bound was [redacted] However, it is prudent to increase this on the back of a stronger 2022. Therefore, the starting point will now be [redacted]. The assumption that load factor will not return to levels higher than 2019 prior to 2026 still holds firm because, at 83% for full year 2019, this was the highest load factor Dublin Airport ever achieved, with peak Summer months reaching 89%.

4.3.3 Applying these changes to Dublin Airport's model, the resulting updated forecast is:

- **FIGURE 4.1 DUBLIN AIRPORT'S MODEL UPDATED FORECAST**

[redacted]

4.3.4 [redacted] However, we broadly confirm the original forecast for 2025 and 2026 as traffic returns to normal levels of growth once it reaches 2019 levels. That is similar to the assumptions that the Commission have made by using the econometric model to project their 2026 forecast. [redacted]

- **FIGURE 4.2 DUBLIN AIRPORT VS CAR FORECAST**

4.3.5 Dublin Airport believe that, this is a realistic yet challenging target [redacted]. This traffic forecast is still below the Commission's projection, but it represents a more realistic mid-range scenario over the next regulatory period from 2023-2026 when all of the current risk factors are considered. This is supported by the following evidence:

4.3.6 [redacted].

4.3.7 Dublin Airport's CAGR for the period 2023-2026 is [redacted] The differences in the forecast are the starting point, in which the Commission have assumed a [redacted]

4.3.8 This forecast is significantly challenging when the downside risks are considered, most specifically the uncertainty of the UK market and the decline of business traffic. Certain routes depend on business traffic to remain viable. As outlined in the traffic risks section, it is not expected that business travel will return to pre-pandemic levels until 2026.

4.3.9 The capacity variable in the model is based on the EUROCONTROL seven-year forecast (15th October 2021). From this forecast, the Terminal Navigation Service Units (TNSU) for Ireland were used. By 2026, it shows a high case of 116% change and a low case of 90% change. Using this version of the EUROCONTROL forecast as the driver for Dublin Airport capacity fits within the current capacity constraints. The implicit capacity variable of ACI's latest forecast would either result in an assuming capacity that is not practically feasible for Dublin Airport or assuming Load factors and Aircraft side that are out of line with the Dublin Airport's market intel and 2019 experience.

- **FIGURE 4.3 EUROCONTROL SEVEN-YEAR FORECAST**

Terminal Navigation Service Units (Thousands)		2019	2020	2021	2022	2023	2024	2025	2026
Ireland	High	.	.	71	178	203	206	211	219
	Base	188	71	70	166	175	183	187	191
	Low	.	.	67	120	140	149	167	170
Ireland - % of 2019	High			38%	95%	108%	110%	112%	116%
	Base			37%	88%	93%	97%	99%	102%
	Low			36%	64%	74%	79%	89%	90%

4.3.10 As stated within the EUROCONTROL Forecast Update 2021-2027, European aviation capacity has stagnated.[13]

4.3.11 Furthermore, the ACI Europe forecast provided a second sanity check for the previous forecast. However, the latest iteration, which would place Dublin Airport at c. 39 million in 2026 and therefore, should not be considered a realistic forecast to benchmark against. Dublin Airport still tracks in line with the October 2021 iteration of the forecast for the 2024-2026 years. However, they are tracking in line with the May 2022 iteration for 2022 and 2023.

- **FIGURE 4.4 ACI EUROPE VS DUBLIN AIRPORT FORECASTS**

(Source: ACI, Dublin Airport)

4.3.12 This traffic forecast is still below the Commission's projection, but it represents a more realistic mid-range scenario over the next regulatory period from 2023-2026 when all of the current risk factors are considered.

[13] EUROCONTROL Forecast Update 2021-2027 | EUROCONTROL

4.4 Traffic Risks

4.4.1 The demand environment is still hugely volatile with several downside risks to traffic outweighing any potential upside. There remains a significant possibility that one or a number of these risks will materialise and cause an impact on Dublin Airport's traffic forecast for the period. Therefore, any forecast should adjust for these potential downsides, or any upside should be offset.

Inflation

4.4.2 The Economic and Social Research Institute (ESRI) has stated that within their Q2 publication that a notable share of savings was diverted from disposable income to savings. It is speculated that with the growing uncertainty within the economy alongside the war within Ukraine, households could reduce their expenditure on luxuries and exercise cautionary practices with the continuation and or increment in savings[14].

4.4.3 It's now predicted that GDP within Ireland will grow by 6.8% for 2022 within an inflationary average of 7.1% by the Economic and Social Research Institute (ESRI) though the European Commission is a slightly higher figure of 7.3%[15].

4.4.4 With the heightening costs of living, the Central Bank has clearly identified that real income is significantly decreasing within Irish households[16]. As pent-up demand begins to fall coupled with the growing economic uncertainty, households may endeavour to continue to save for precautionary reasons. These factors have the potential to slow down discretionary spending on leisure travel.

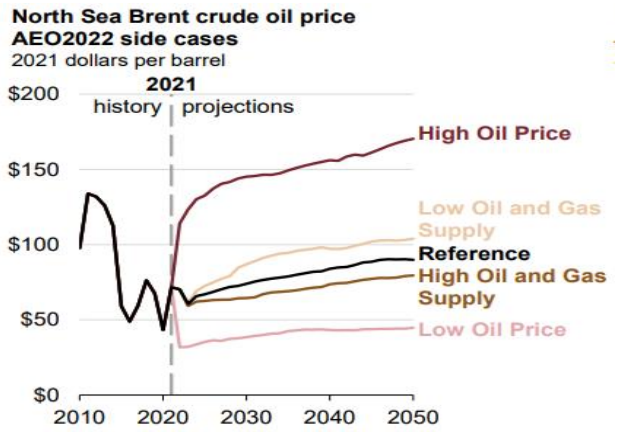
Fuel

4.4.5 With the strengthening dollar and increased cost of fuel, air operators will continue to feel the worsening effects as they continue to develop. As previously noted by Dublin Airport airline's fuel hedging policies will provide a degree of certainty in their financial outlook, though the pressing fluctuations of jet fuel price has already caused European airlines such as Wizz to reverse strategic decisions regarding fuel hedging[17]. With drastic actions such as these already taking place, there is the rising likelihood that airlines could decrease capacity on unviable routes.

4.4.6 With the effect of Russia's full-scale invasion of Ukraine continuing to impact the fuel and energy sector, the Energy Information Administration (EIA) is currently demonstrating a spot price of Brent crude oil at an average of $105 per barrel in 2022 and an average $95 per barrel in 2023[18]. Rising interest rates and fears of developing recession is continuing to strengthen the U.S. dollar.

[14] Quarterly Economic Commentary, Summer 2022 (esri.ie)
[15] Economic forecast for Ireland (europa.eu)
[16] Higher real income growth, reduced spending and precautionary savings contributed to significant increase in Irish household deposits during the pandemic (centralbank.ie)
[17] Wizz Air Abandons No Fuel Hedging Policy as Oil Prices Surge - Bloomberg
[18] Short-Term Energy Outlook - U.S. Energy Information Administration (EIA)

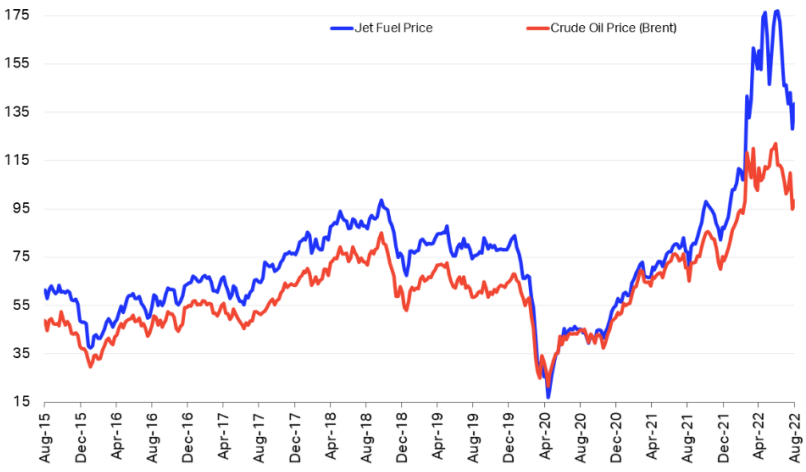
- **FIGURE 4.5 BRENT CRUDE OIL PRICE PROJECTION**



(U.S. Energy Information Administration (EIA))

4.4.7 In comparison to August 2019, jet fuel is now up 60% currently trading at $138 per barrel[19]. This undoubtably has impacted airlines majorly on a global basis especially operators without a fuel hedging policy. As previously stated by Dublin Airport, our largest customers report being hedged 80% for FY22/23 with approximately 5% hedged for FY24 (Ryanair)[20] and 60% (IAG). Though with jet fuel remaining at record highs, a cost uncertainty will be noticeable within customer airlines who have no current hedging policy.

- **FIGURE 4.6 JET FUEL PRICE VS CRUDE OIL**



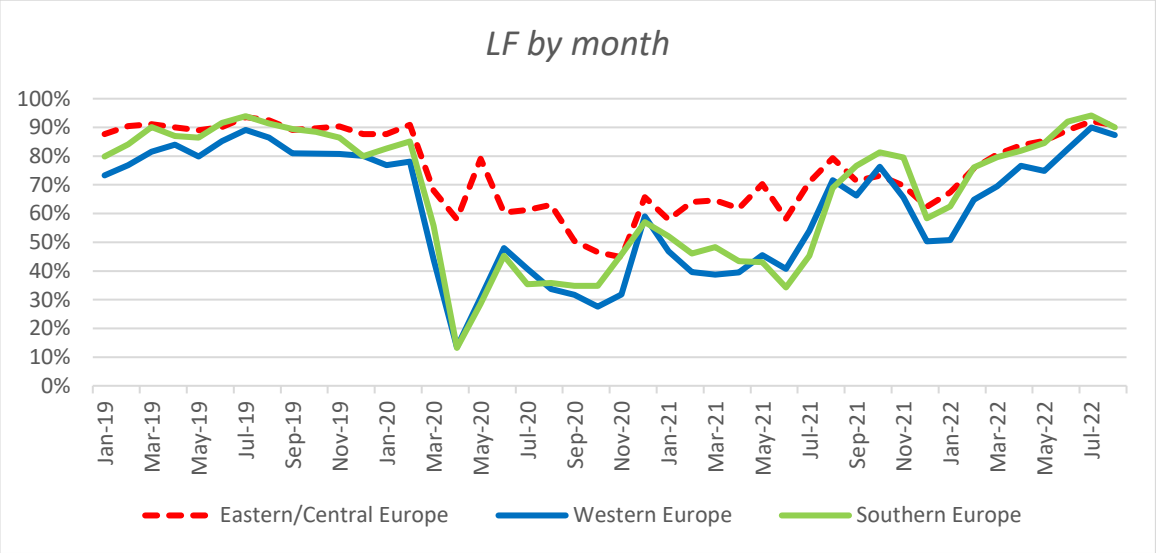
Source: S&P Global, Refinitiv Eikon

[19] IATA - Fuel Price Monitor
[20] Ryanair-2022-Annual-Report.pdf

Eastern Europe

4.4.8 As previously noted by Dublin Airport, there had been a direct impact to passenger traffic due to the Russian invasion of Ukraine. Eastern/Central Europe saw a positive recovery, demonstrated by near to 2019 level load factors throughout the summer months of 2022. Though given the weight of this region, the risk of any volatility surrounding the Ukrainian territories must be recognised, as it does pose a potential threat to affect the traffic performance with a near to immediate effect.

- **FIGURE 4.7 EUROPE REGION LOAD FACTOR BY MONTH**



(Source: Dublin Airport)

COVID-19

4.4.9 Although restrictions have effectively been removed completely, the Health Service Executive of Ireland (HSE) is currently analysing potential scenarios that may be found difficult going into the Winter months and what impacts from COVID-19 could occur. Potential outbreaks of the diseases going forward could disrupt air travel, especially if travel restrictions were re-imposed.

4.4.10 The World Health Organisation (WHO) has forecasted a challenging autumn and winter within the European Regions as COVID-19 positive cases rose drastically throughout the summer months[21]. This could cause a noticeable drop in travel demand and certainty as the industry progresses into a an already speculated harsh economic winter.

Capacity Issue

4.4.11 Summer 2022 has exposed the difficulties faced by the aviation industry on a global scale in the near immediate ramp up of demand in air travel. Due to challenges faced by airports,

[21] Rapidly escalating COVID-19 cases amid reduced virus surveillance forecasts a challenging autumn and winter in the WHO European Region

airlines and service providers there has been an unfortunate knock-on effect felt by passengers across Europe. Albeit Dublin Airport initially faced issues with processing passengers throughout the Dublin Airport campus, there have been zero flight cancellations due to capacity restrictions imposed by Dublin Airport.

4.4.12 We look at other major airports such as Heathrow, who recently announced an extension to their summer capacity restriction of 100,000 passengers per day now valid until 29th October 2022[22]. Such measures will have major impacts on airline capacity, with British Airways cancelling 629 flights from the remainder of its Summer 22 season and 10,000 seats on it's short-haul network (8% Winter 22/23 season)[23] . Outcomes such as this must be considered going forward as the Dublin Airport continues the recovery.

Brexit

4.4.13 Brexit continues to hamper the recovery of the air corridors between Dublin-UK traffic. As of 31st January 2020, Brexit has influenced the poor performance of UK traffic. The sterling pound has been ranked as the worst performer out of G10 currencies so far in 2022[24]. This further impacting to the challenges faced by British operators as GBP has reached a two year low against the USD[25].

- **FIGURE 4.8 GBP VS USD**

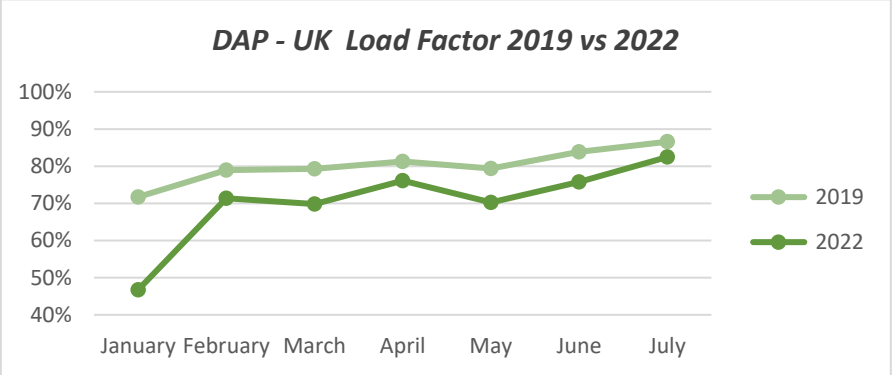
(Source: Pound Sterling Live, Tradingview.com)

[22] Heathrow implements summer 2022 capacity cap | Heathrow
[23] BA to cut more than 10,000 flights from winter schedule | Financial Times (ft.com)
[24] Sterling slumps 0.5% vs euro ahead of UK GDP data | Nasdaq
[25] Pound Slumps to Fresh Two-year Lows against Dollar (poundsterlinglive.com)

4.4.14 Alongside exchange rate challenges, UK GDP also contracted within Q2 of this year confirming that the UK economy has entered low-growth and high inflation phase. With Bank of England projecting the '*UK to enter recession from 2022 Q4*[26]' which has the potential to last until 2024. It is paramount for the Commission to acknowledge the continued negative impact that Brexit continues to inflict on passenger numbers to/from Dublin Airport.

4.4.15 Although there is a positive trend in Load Factors across routes between Dublin Airport and the UK there is still a significant decrease 5% on average from January – July of 2019 vs 2022 even with an operator induced capacity reduction due to operational constraints of 17% for the same period.

- **FIGURE 4.9 DUBLIN - UK LOAD FACTOR 2019 VS 2022**



(Source: Dublin Airport)

Business Traffic

4.4.16 GBTA previously forecasted full recovery of global business travel spending by 2024 though it is now expected that impacts are anticipated into 2025, with pre-pandemic 2019 levels not being reached until 2026[27]

4.4.17 Recovery so far in 2022 was positive, with global factors such as vaccination effort, travel policies and business traveller sentiment all improving within the first half of the year. Though deteriorating economic conditions including challenges involving supply chains, labour shortages and regional implications such as lockdowns in China and the ongoing war in Ukraine have created stumbling blocks throughout the global recovery.

Planning Restrictions

4.4.18 The Aircraft Noise Competent Authority (ANCA), a unit of Fingal County Council published in August of this year their notification of decision to grant permission to Dublin Airport. This will consist of an annual Noise Quota Scheme (NQS) which will be implemented from 1st April to 31st March each year, limiting to 16,260 movements annually between 23:00 – 06:59L[28]. With

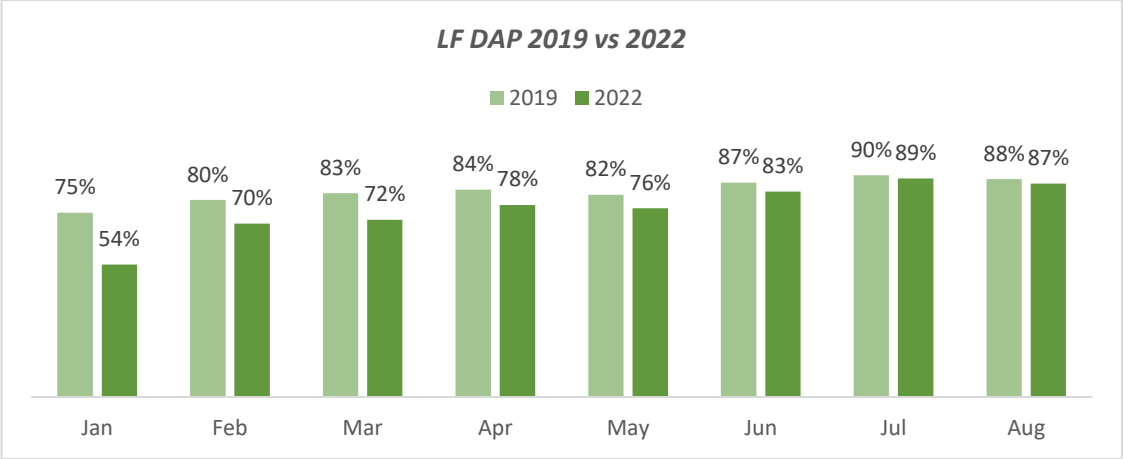
[26] Monetary Policy Report - August 2022 | Bank of England
[27] Global Business Travel Spending is Coming Back, but Recent Headwinds Push Anticipated Full Recovery Into 2025 and 2026 - Global Business Travel Association - GBTA
[28] 00747949.pdf (fingal.ie)

the NQS to be implemented by 2024, this will inevitably impact base carrier operations at Dublin Airport alongside the relative traffic.

Load Factor Performance

4.4.19 Overall Dublin Airport has had a positive Load Factor performance supported by the pent-up demand coupled with the first summer season post COVID-19 without significant travel restrictions. Though as the holiday period draws to a close without hitting 2019 levels, Dublin Airport will have to continue to monitor the performance as we enter the Autumn and Winter months. With the immediate outlook looking soft, it is difficult to predict the performance of the Midterm and Christmas peak periods.

- **FIGURE 4.10 DUBLIN AIRPORT LOAD FACTOR 2019 VS 2022**



(Source: Dublin Airport)

Capacity Constraints

4.4.20 As previously noted by Dublin Airport, aircraft levels have returned to near Summer 2019. While there has been challenges in on time performance regarding stand allocation the airport has continued to fully operate the current stand allocations in place. Though with the opening of the North Runway in August 2022, there will be no new stands prior 2024 to immediately compliment this major infrastructure addition. As the construction and development of new stands gets under way, Dublin Airport will have to effectively manage the current growth projections into Summer 2023.

Supply Chains

4.4.21 As it has been well noted supply chains across the world were and are still being affected by COVID-19 lockdowns, lack of raw material and labour shortages with speculations that these

challenges will continue until 2023-2024. Boeing will continue to limit their production of 737 Max aircraft until further certainty within their supply chains is observed[29]. With Ryanair having a firm order of 210[30] B737-8200 and Aer Lingus owner (IAG) agreeing an order of 25 B737-8200 / 25 B737-10 aircraft, plus 100 options for expected delivery between 2023-2027[31]; it is reasonable to acknowledge the potential impact a delay in either operator's fleet expansion could have to the further growth in traffic volumes at Dublin Airport throughout the coming years.

Passenger Forecast Chapter Summary:

- Dublin Airport believe that the methodology that the Commission have undertaken is rational if it is transparent and the correct variables are considered.
- It is believed that the Commission's output of the forecast, while plausible, represent an optimistic scenario which does not reflect the views of industry stakeholders or the realities at Dublin Airport. Considering the current risks, as outlined, it is not realistic to achieve.
- The risks to traffic have only heightened since the regulatory submission with inflation and interest rates rising, cost of living increasing and the price of fuel remaining high.
- Despite this negative outlook, Dublin Airport have proposed an updated forecast, which increases the years 2022-2024. Normal growth will return to 2025 & 2026, with these years remaining similar to the previous forecast culminating in [redacted] in 2026 (Dublin Airport have added [redacted] passengers to their forecast)
- The latest iteration of the ACI Europe forecast, while possible for all European airports combined, is not a realistic target for Dublin Airport, with 2026 forecasted to reach 118% of 2019.

[29] Boeing CEO: Supply chain issues are hindering 737 Max production increase (cnbc.com)
[30] Ryanair-2022-Annual-Report.pdf
[31] IAG – International Airlines Group – Boeing-737-8200-and-737-10-order (iairgroup.com)

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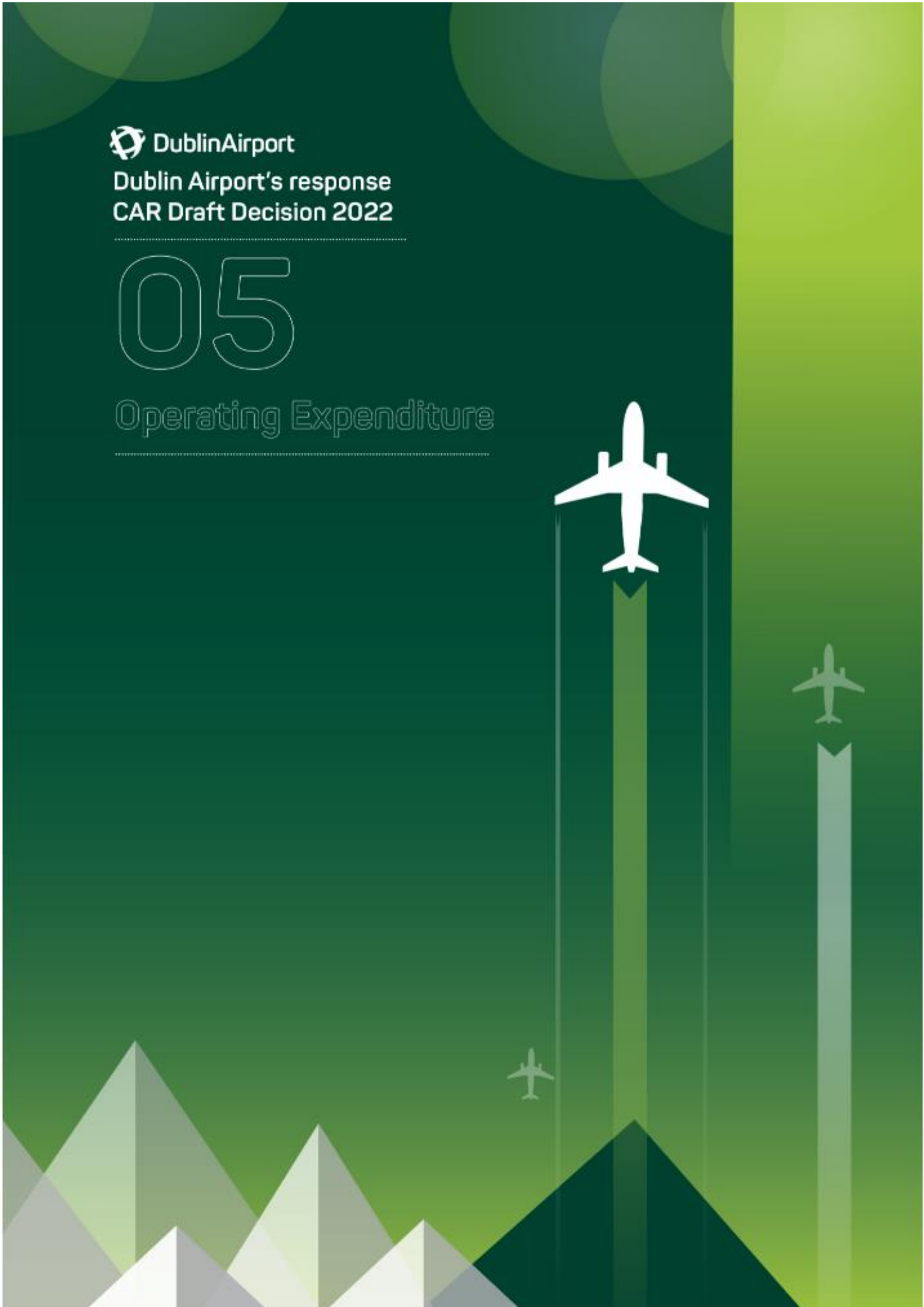
05

Operating Expenditure



5. Operating Costs

5.1 Introduction

5.1.1 The Commission's Draft Decision on opex does not reflect the current context for Dublin Airport or European aviation in general. The Commission's objectives provides significant latitude to assess efficiency while also taking into account what has occurred to the operation over the past 30 months plus the increased forward-looking volatility and risk that currently exists.

5.1.2 Dublin Airport spent 24 months between April 2020 and March 2022 in financial survival mode and has now moved into recovery mode.

- Survival was characterised by reducing cash outflows as much as practicable.
- Recovery is being characterised by volatile demand and staffing with a sharp increase in demand leading to a deterioration in the level of service. This meant that Dublin Airport had to put in place operational contingency measures to ensure that passengers were able to fly. There is still significant uncertainty about the speed of recovery of passenger volumes and the resource levels required to match passenger requirements.

5.1.3 In satisfying its objectives it does not mean that an efficient outcome is one where operational expenditure allowances nor aeronautical charges are as low as possible. Indeed, wider considerations about speed or recovery, resilience of operation and service proposition are implicit within the Commission's objectives.

5.1.4 The Commission should not set out to simply minimise the notional cost base of airport operating in a "steady state" but must consider how other, efficient and effective, airport operators would organise their operation in the current context of increased volatility, changed passenger behaviour and rebuilding an operation from virtually zero activity a full operation over 24 months.

5.1.5 The 2022 Draft Decision also misinterprets the actions taken by Dublin Airport in 2020 and 2021. These actions were primarily taken to mitigate the immediate impact from the loss of revenues in 2020 and 2021 and secondly to size the post COVID-19 operation for initial passenger traffic of c20mppa and must be reviewed in this context. The opex allowance in the draft decision takes some of the cost reductions and holds them through the determination period where in reality it is more likely that cost levels will revert to 2019 levels. If these cost lines remain at 2021 levels, there is no possibility of Dublin Airport returning to 2019 levels of service. This is a fundamental fact the Commission must not lose sight of in its decision-making process.

5.1.6 The granularity of CEPA's approach means there are a very large number of decisions made, many of which err on the side of being too conservative/stringent. Although many of these individual decisions are small in the context of Dublin's overall cost base, the collective impact

of all of these changes leads to a substantial challenge—this is particularly true in security (e.g. selective use of evidence from the ACI report).

5.1.7 In a similar context, the Civil Aviation Authority raise the possibility for such issues to arise when setting an OPEX allowance through a granular approach, in the context of Heathrow Airport. "*Having considered CTA's [CEPA/Tailor-Airey] analysis in detail, we are conscious that CTA has made a relatively large number of assumptions on the detail of HAL's cost base to complete its analysis. While we regard the assumptions and approach that CTA has adopted as reasonable, there are plausible ranges for most of the assumptions that CTA has made and in these circumstances it is appropriate to also consider top-down cross checks on the reasonableness of the CTA's…*"[32]

The draft opex allowance does not provide for a resilient operation

5.1.8 The Draft Decision has made no allowance for the magnitude of change that has occurred in the industry and at Dublin Airport since March 2020, represents a clear and manifest error in regulatory decision making:

- Passenger levels reduced to <15% of normal activity for 15 months before pent up demand drove passenger levels back to 75% of normal activities within 8 months.
- A c900 (-30%) FTE reduction in staffing, followed by re-hiring and training >500 staff in an employee market with 4.2% unemployment.
- Soaring inflation.
- A vastly different passenger profile, with increased leisure travel, earlier presentation profile and a knock-on increased dwell time. Leisure travellers, by their nature of travelling less often than business travellers, are more resource intensive for Dublin Airport as they carry more luggage, are more likely to use check-in and are less familiar with the airport layout and facilities.
- Moved to a changed operating model for cleaning in terminal 1.
- Third party suppliers also ramping up operations at the airport, impacting Dublin Airport in terms of additional non-pay costs (passed through) and Dublin Airport's ability to secure resources at rates that would have prevailed previously.

5.1.9 The difficulty of getting this right has been evidenced in the operational difficulties seen at Dublin Airport and across Europe this summer.

5.1.10 The combination of uncertain demand with a starting point of an under resourced operation legitimately demands a fresh regulatory approach to reviewing the efficient level of opex at Dublin Airport. It is realistic to assume that any efficient and effective operator would respond to the current circumstances by building more resilience into its operation. It is important that the Commission does not define the "notionally efficient airport" operating in a "steady state" environment, as it has been the case in previous determinations.

[32] Civil Aviation Authority (2022), 'Economic regulation of Heathrow Airport: H7 Final Proposals Section 2: Building Blocks', June, para. 4.63.

5.1.11 The notionally efficient airport must be set in the current context, and therefore operational allowances must include:

- Cost allowances that enable Dublin Airport to rebuild its operational capabilities back to 2019 levels in a timely manner.
- Cost allowances that enable Dublin Airport to run a resilient operation. This would include essential services like Security, Facilities & Cleaning and PRM services and could mean building operational capabilities ahead of full recovery of volumes.
- Cost allowances that enable Dublin Airport to offer a service quality condition that meet changed passenger demographics and behaviours as well as increased passenger expectations such as increased expectations on cleanliness.

5.1.12 In practical terms there are a number of options for this, such as:

- Including opex allowances that plan for demand one year ahead i.e. for key service opex lines such as Security, Facilities & Cleaning and PRM services the level of opex would be based on the passenger levels for the following year.
- Applying a glide path for the first couple of years of the determination period to these key service opex lines.

5.2 Commission's Opex Review Methodology

5.2.1 The Commission has not followed best regulatory practice when it comes to setting an opex allowance for the coming regulatory period. The standard approach that regulators follow includes the following steps

- **Step 1: Assessment of base year efficient costs / benchmark.** UK regulators would seek to establish whether the company is operating at the efficiency frontier at the start of the price control determination. Regulators usually justify their findings by using industry and/or international benchmark and "bottom-up" assessment of key cost categories.
- **Step 2: Assessment of catch-up efficiency challenge.** If inefficiency is identified, regulators would introduce "catch-up" efficiency measures to move the company towards the efficiency frontier. In general, this would be done by leveraging the "bottom-up" assessment outlined in step 1.
- **Step 3: Assessment of ongoing efficiency /"Frontier shift".** The final efficiency challenge that UL regulators tend to introduce relates to the general productivity improvements of the economy, usually termed "frontier shift" (i.e. the efficiency frontier does not stand still). This is a top-down efficiency challenge which is quantified by econometric analysis.
- **Step 4: Scrutiny of the regulated companies' forecast.** Irrespective of whether the regulated company enters the price control as an efficient operator. Regulators would interrogate the regulated company' forecast by reviewing the proposed methodology and assumptions, this would include reviewing cost drivers, elasticities, proposed overlays due incremental investment, additional services, etc. Where the regulator disagrees with the methodology and assumptions, it would replace the companies' assumptions with its own

- **Step 5: Consistency checks.** The final step that UK regulators would do is to perform checks to their proposed forecast to ensure that it is challenging yet deliverable. This would include descriptive statistics, high-level comparison with previous determinations, use of projected benchmarks.

The Commission's methodology does not address these steps in the following ways:

- The Commission does not consider whether the efficient frontier has shifted since 2019. In the context of the magnitude of change over the intervening three years, as described above, this is a considerable omission. As also outlined above, the efficient operator will behave differently in a period of uncertainty and change. Were Dublin Airport typically operating in a context of annual contraction and expansion of the passenger base in excess of 50%, it is unlikely that an appropriate opex settlement would align to that made at the 2019 determination (set for an airport with steady and stable growth in passenger numbers). That Dublin Airport has had to unexpectedly adapt to this operating environment further increases the level of opex it can be expected that it would need to commit to maintain a high quality of service.
- The Commission has not examined how Dublin Airport would be able to meet CEPA's forecast. In the 2019 final determination the Commission allowed a glidepath for the first two years of the regulatory period. Omitting this step fails both step 2 and step 5. This may link to the erroneous conflation of cost reductions in response to a fall in volumes with enduring long-run efficiency improvements.
- There is limited evidence of a detailed review of Dublin Airport's opex forecast. Many of the differences identified in this response have been highlighted in Dublin Airports proposition document and have not been addressed by either CEPA or the Commission.
- Elements of the opex forecast are inconsistent with the Commission's Commercial Revenue forecast and also the increase in service quality targets.

5.2.2 The draft decision also misinterprets the actions taken by Dublin Airport in 2020 and 2021. These actions were primarily taken to mitigate the immediate impact from the loss of revenues in 2020 and 2021 and secondly to size the post COVID-19 operation for initial passenger traffic of c20mppa. The opex allowance in the draft determination takes some of the exceptional cost reductions and holds them through the determination period where in reality it is more likely that cost levels will revert to 2019 levels. If these cost lines remain at 2021 levels, there is no possibility of Dublin Airport returning to 2019 levels of service.

The granularity of CEPA's approach means there are a very large number of decisions made, many of which err on the side of being too conservative/stringent. These combine to set a substantial challenge—this is particularly true in security (e.g. selective use of evidence from the ACI report). When the Commission's approach to financeability assumes that all of these are achieved in a base case, this has a knock-on impact on the overall financeability of Dublin Airport.

5.3 Dublin Airport's response to the Commission's Operating Cost Assessment

Commission's opex allowance results in an opex deficit of €150m over 4 years

5.3.1 Dublin Airport prepared a robust and detailed opex forecast as part of the overall regulatory proposition for 2023 to 2026. This forecast includes a [redacted] efficiency saving between 2019 and 2026.

5.3.2 Since the original submission Dublin Airport has experienced significant operational challenges which highlight the importance of having the correct resources in place, in particular for the essential services of security and facilities. In response to these challenges, Dublin Airport reassessed its security opex forecast and submitted an addendum to its opex forecast.

5.3.3 The Commission's draft opex allowance disallows €150m of Dublin Airport's cost base, increasing to 14% of Dublin Airport's opex cost in 2026. Such a material reduction in opex will significantly impact the quality of operation and service at Dublin Airport. It will also have a knock-on impact into the financeability of the overall pricing decision, pushing Dublin Airport to delay capital investment and thus compounding the impact on passenger service and overall airport operations. Such a scenario would present an appalling prospect for the travelling public.

- **FIGURE 5.1 – OPEX DEFICIT BY YEAR**

[redacted]

5.3.4 The Commission's opex forecast fails to adequately remunerate Dublin Airport's security and facilities operation, does not accurately reflect Dublin Airport's cost of employment and includes a number of errors or oversights on Dublin Airports non-pay costs.

5.3.5 This under-resourcing of Dublin Airport's front-line operation occurs against the backdrop of widespread operational challenges across the European aviation industry.

- **FIGURE 5.2 – SPLIT OF 2026 OPEX DEFICIT**

5.3.6 Dublin Airports evidential response to the Commission's draft opex determination is included in Appendix 1. Detailed responses are included for all material variances noted and updates are included for changed cost estimates for Energy and Cleaning costs.

5.4 Dublin Airport's Proposed Opex Proposal for 2023-2026

5.4.1 As per our 2022 Regulatory Proposition which was further updated by our Addendum in June 2022, Dublin Airport is proposing the following operating cost allowance is required for 2023-2026.

- **FIGURE 5.3 – OPEX FORECAST BY YEAR**

Uncertainty Mechanism

5.4.2 In the 2019 Determination, the Commission introduced an operating cost pass through mechanism. This was to allow for certain unanticipated operating costs outside the control of Dublin Airport, to feed through to the price cap within the regulatory determination period. The costs eligible for recovery under this scheme was limited to

- Local Authority Rates applicable to the regulated entity and not rechargeable.
- Energy cost variations year on year.
- Direct charges set out in new or amended primary or secondary legislation, which are outside the control of Dublin Airport.

5.4.3 Dublin Airport requests the inclusion of this measure in the price cap formula for the regulatory period 2023-2026. While we are supportive of the current structure and application of the mechanism, we are requesting that the Commission potentially extends the application of this scheme to include a broader range of non-payroll costs that are beyond the direct control of the daa.

5.4.4 Dublin Airport believes that a broader range of non-controllable costs should be included in the cost pass through mechanism in order to safeguard the airport from excessive risk from spiralling operating costs which are beyond the company's control. For example, there is currently an exceptional high degree of risk for the airport around energy and security related costs. If energy costs are not included as per our request in the uncertainty mechanism, at a minimum, the latest forecasts for inputs such as energy should be included as an update to the final Decision. This in line with precedent from regulators such as the CAA for Heathrow.[33]

5.5 Conclusion

5.5.1 For the reasons set out above it is our view that the Commission is required to revisit the Draft Decision's proposals for operating cost allowances (in particular for airport security) and to grant Dublin Airport additional headroom / allowances that are essential to ensure that it can withstand cost challenges and continue to meet the reasonable needs of airport users.

5.5.2 In the current circumstances, where there is a large divergence between the forecasts of the Commission (informed by reports by CEPA) and Dublin Airport for opex, the Commission must provide fully reasoned justifications for why it is rejecting Dublin Airport's forecasts and not including the allowance sought. This must take into account the drastic changes in the industry, such as the costs of recovery from cost-cutting etc. during the COVID-19 crisis, the volatility in economic markets and passenger numbers/travel patterns, wage inflation and rising interest rates. It is our strong view that the Draft Decision fails to do so and does not meet to the required regulatory or legal standards.

5.5.3 In relation to opex, it is Dublin Airport's strong view is that we must be allowed additional headroom and robust allowances in relation to FTE count and wage inflation assumptions, taking into account the unique future challenges ahead. The Commission should be aware that this requirement was outlined in the instructive decision of the UK Competition & Markets Authority ('CMA') in Firmus Energy (Distribution) v Northern Ireland Authority for Utility Regulation.

[33] CAA (2022), 'Economic regulation of Heathrow Airport: H7 Final Proposals Section 2: Building Blocks', June , para. 4.61. "*CTA [CEPA/Tailor Airey] updated its analysis across all categories of opex since our Initial Proposals, primarily based on new information from HAL. The key areas in which CTA's analysis has changed since our Initial Proposals (other than using updated passenger forecasts) are:… …utility costs, for which CTA has increased its estimate to allow for updated higher forecasts by HAL of energy cost inflation. This change increases estimated opex by £90m*".

5.5.4 The CMA found that while the base costs are the regulator's default position, adjustments can (and ought to) be made where there are atypical costs in a given year and where there is sufficient evidence that the costs over the given period are materially different to those in the base year[34]. Similarly, the UK Civil Aviation Authority stated in its Final Proposal in relation to airport charges at Heathrow Airport that the price cap was adjusted to reflect the increase in inflation, and expected inflation reduces the real cost of much of Heathrow Airport's existing debt.

5.5.5 It is clear from the relevant legal principles and precedents that the Commission is required to make evidence-based decisions and must not make decisions which are irrational and reflect inadequate consideration of submissions by Dublin Airport. Where the Commission is proposing to rely on forecasts which are not closely linked to actual historic data and are very different to Dublin Airport's, the Commission must therefore evidence to a high standard of probability that its projection should be favoured over Dublin Airport's, and we submit that this evidence base and standard has not been met.

5.5.6 In addition, where there is significant uncertainty, the applicable legal principles favour adopting a flexible approach should be adopted to reflect the high level of risk facing Dublin Airport.

[34] CMA Final Determination, Firmus Energy (Distribution) Ltd V Northern Ireland Authority for Utility Regulation, 26 June 2017.

Operating Costs Chapter Summary:

- The Commission's draft decision on opex does not reflect the current context for Dublin Airport.
- The 2022 Draft Decision will result in an opex deficit of [redacted] over 4 years this will not allow for a resilient airport operation.
- Alternatively, Dublin Airport is forecasting a required opex allowance of [redacted] in [redacted] in 2026.
- The granularity of CEPA's approach to opex means there are a very large number of decisions made, many of which err on the side of being too conservative/stringent. These combine to set a substantial challenge for airport operations.
- The Commission should not set out to simply minimise the notional cost base of airport operating in a "steady state" but must consider how the operating costs required for an efficient and effective operation.
- Dublin Airport must be allowed additional headroom / allowances in relation to FTE count and wage inflation assumptions, taking into account the unique future challenges ahead.

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Dublin Airport's response CAR Draft Decision 2022

06 Commercial Revenues

6. Commercial Revenue

6.1 Introduction

6.1.1 In its 2022 Draft Decision, the Commission has set ambitious commercial revenue targets with total revenue forecast to grow from €281m in 2019 to €319m in 2026. On a per passenger basis this is an increase of 6% to €9.05 (Feb 2022 prices).

TABLE 6.1 COMMERCIAL REVENUE DUBLIN AIRPORT VS CAR TARGETS

	2023	2024	2025	2026	Total
CAR Commercial Revenue Target (€m)	259.0	280.2	305.0	318.8	**1,163.0**
DAP Commercial Revenue Forecast (€m)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Variance (€'m)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Variance per passenger (€)*	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

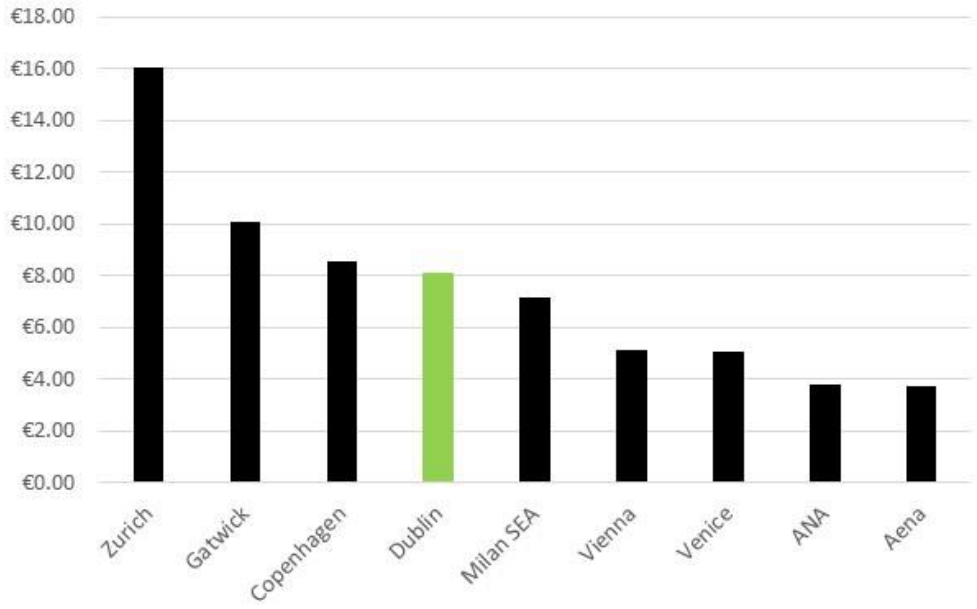
(Source: Dublin Airport, CAR Calculations)
* Based on original Dublin Airport traffic forecast

6.1.2 In contrast Dublin Airport presented its commercial revenue forecasts for 2023-2026 in its 2022 Regulatory proposition where it projected total commercial revenues of [redacted] in 2023 increasing to €[redacted]m in 2026. The cumulative difference between the Dublin Airport and the Commission forecasts over the period is €xxm.

6.1.3 Dublin Airport has prepared forecasts on a bottom-up basis building on our knowledge of our commercial business, assessment of the unique set of challenges that we will face in 2023-26 and analysis of wider trends in each of our business segments.

6.1.4 High-level benchmarking to other European airports suggests that our total commercial revenues per passenger are in line with Copenhagen and the Milan airports, and higher than Aena, ANA, Venice and Vienna. Gatwick and Zurich have higher commercial revenues per passenger. These figures are based on commercial revenues and passenger numbers declared in the comparator airports' annual reports. Care therefore needs to be taken when interpreting these numbers due to potential differences in the scope and reporting of commercial revenues, which could mean they do not reflect a like-for-like comparison.

TABLE 6.2 COMMERCIAL REVENUES PER PASSENGER AT EUROPEAN AIRPORTS (2019, €/PER PASSENGER)



6.2 Context for the Commercial Revenue Assessment

6.2.1 The macroeconomic situation has evolved quickly following our regulatory proposition, with the high inflation environment, rising interest rates and cost of living crisis likely to have an impact on our commercial business. In particular since the commercial revenue targets were proposed there has been a notable deterioration of consumer sentiment in the Irish market. Recent consumer sentiment survey conducted by KBC bank Ireland/ESRI consumer sentiment index shows that Irish consumer confidence has weakened from 77.0 in February 2022 when Dublin Airport finalised its commercial revenue forecasts to 53.7 in July 2022.

6.2.2 We agree with the Commission's approach in taking 2019 outturn per passenger as the basis for the 2023 starting position. To take outturns from 2020-2022 would be flawed given the materially lower passengers in 2020/21 and at the start of 2022 and also the fact that since passenger volumes have recovered in 2022 the Irish originating proportion has increased to 62% in Q2 2022 up from 52% in Q2 2019.

6.2.3 In setting its commercial revenue projections for the period 2023-2026, the Commission has applied its passenger traffic projections which it set for the 2022 Draft Decision. The Commission has proposed a passenger volume forecast higher than the passenger volume set out in Dublin Airport's 2022 Regulatory Proposition. This has resulted in a differential between the Commission and the Dublin Airport commercial revenue forecasts of [redacted] for 2023-2026.

6.2.4 We welcome the Commission's proposal to reintroduce the rolling incentive scheme for the period 2023-2026, however the proposal for the carry-forward to be capped at 10% will likely exclude more material initiatives.

6.2.5 We note that the Commission has not included a capital allowance or associated revenue target for the pick-up and drop off project, not only will this project improve the efficiency of the departure roads it will also have the added benefit of reducing airport charges due to the additional contribution of [redacted] per annum, so we therefore ask that the Commission reconsider their decision not to include this allowance.

6.3 Dublin Airport's response to the Commission's Commercial Revenue Assessment

Passenger Forecasts

6.3.1 In setting its commercial revenue projections for the period 2023-2026, the Commission has applied its passenger traffic projections which it set for the 2022 Draft Decision. The Commission has proposed a passenger volume forecast higher than the passenger volume set out in Dublin Airport's 2022 Regulatory Proposition. Dublin Airport has outlined its response in relation to this regulatory building block in chapter 4.

6.3.2 In the 2022 draft decision, the Commission proposed a passenger volume forecast which is based on an average annual growth of 9% while Dublin Airport is proposing traffic growth of 6% per annum for 2023-2026. This will lead to a 1.1m differential in forecast passenger numbers by 2026. The passenger forecast variance results in higher commercial revenues of c [redacted] over the period 2023-2026.

Consumer Sentiment

6.3.3 Consumer sentiment has fallen back again to levels last seen during the COVID crisis in 2020, continuing the trend from Q1. Driven by a lack of confidence in the world economy as a whole. Closer to home, the main concerns exist around energy, fuel, housing, financial lending and general economic uncertainty.

6.3.4 In a recent KBC consumer sentiment survey 59% of respondents said they intended on cutting back on non-essential spending with 37% saying they intended to cut back on essential spending.

6.3.5 The above clearly signals challenges ahead for commercial revenue generation with particular challenges expected in the more discretionary areas of car parking and retail. This could render the current forecast growth assumptions for these areas unattainable for 2023-2026.

2022 Market Dynamics

6.3.6 While passenger volumes are now increasing at Dublin Airport in the aftermath of the COVID-19 pandemic, it should be noted that there are some short-term factors in terms of market dynamics that are influencing the commercial revenues currently being generated.

6.3.7 Irish originating passenger are accounting for a higher proportion of total passengers. In Q2 2022 62% of passengers were Irish originating this compares to pre-pandemic where Irish originating accounted for 52% of passengers in 2019.

6.3.8 Irish residents are more likely to travel by car to the airport, have higher car park usage and (Dublin Airport Travel Services) DATS usage.

- **FIGURE 6.3 IRISH VS NON-IRISH RESIDENCY TRAVEL**

(Source: Dublin Airport Passenger Tracking Q2 2022)

Car parking capacity

6.3.9 The temporary closure of a competitor car park has resulted in over 6,000 spaces being removed from the market along with the increase in Irish originating passengers has increased the demand for Dublin Airport car parks. This has meant that yield management has been required to ensure car parks do not fully sell out during peak periods i.e., Dublin Airport needs to ensure there is sufficient space for passengers to arrive and park on the day of travel to avoid passengers missing flights and congestion on surrounding roads.

[redacted]

Outlook for Commercial Revenues 2023-2026

6.3.10 Dublin Airport would like to urge the Commission to resist any proposals by other airport stakeholders for further increases in the Dublin Airport commercial revenue projections going forward in the Final 2022 Interim Review Decision. We believe that CAR's current ambitious forecasts will be the maximum that will be potentially achievable over the period 2023-2026.

6.3.11 When forecasting commercial revenues for 2023-2026, the Commission must be cognisant of the following factors that will restrict Dublin Airport's ability to continue to grow commercial revenues in the next regulatory period.

6.3.12 There are a number of supply-side constraints and capacity shortages that are likely to render revenue growth less responsive to passenger traffic increases.

- **Retail floor space:** In order for an airport to maintain and improve its commercial performance, it is necessary for increases in retail floor space as passengers increase beyond 2019 levels.
- **Car parking:** Car parking operations are expected to face capacity constraints again as passenger volumes recover past 2019 levels.
- **Commercial property**: Commercial property reached occupancy of 99% in 2019. This has resulted in some customer requests for property not being satisfied in recent times.
- **Commercial concessions (car hire):** Car rental facilities were operating at capacity in 2019, imposing significant operational pressure on car hire companies and impacting on customer experience.

6.3.13 Internationally, airports' commercial businesses have been under threat for some years as the retail and mobility industries undertake fundamental structural transformations. The reduction in commercial revenues we have observed as a result of COVID-19 has been mirrored across airports internationally.

6.3.14 The Irish economy, and those of other countries internationally, is currently facing a cost-of-living crisis that is expected to last for some time. Consumer price inflation is forecast to average 6.5% in 2022, driven by increasing wholesale energy, fuel and food prices. This is expected to result in falling real incomes and weaker consumer confidence, which in turn are likely to affect disposable incomes and constrain household spending. The latest Central Bank estimates indicate consumption growth of 7.4% in 2022, slowing to 4.7% in 2023 and 3.9% in 2024[35].

6.3.15 Macroeconomic forecasts are currently subject to high uncertainty given the Russian invasion of Ukraine and the drivers of energy price inflation.

6.3.16 The construction of Terminal 2 and other enhancements across the Dublin Airport campus have ensured that capacity had been sufficient to meet growing demand from passengers and businesses alike in the last regulatory period. However, as passenger volumes start to

[35] Central Bank of Ireland (2022), 'Quarterly Bulletin Q2 2022', 6 April.

return to 2019 levels, we expect to see capacity issues across our commercial portfolio that are expected to dampen future growth in commercial income.

CIP projects not included in the commercial revenue forecast

6.3.17 Two commercial CIP projects have not been included within the commercial revenue targets for the period 2023-26 – the drop off and pick up project (CIP.20.04.032) and the OCTB refurbishment (CIP.20.04.034).

6.3.18 For the drop off and pick up project, both the CIP allowance and commercial revenue target have been excluded from the draft decision. As stated in the Dublin Airport proposition document this project has multiple drivers including removal of congestion and traffic build up on the departure roads, extend the asset life of existing infrastructure, together with introducing a product and associated commercial return. The project is expected to deliver an incremental income statement benefit of c. [redacted] p.a. by 2026 which would result in lower airport charges by c. [redacted]ent per passenger. Based on the above information this project and associated revenue target should be included in the final decision.

6.3.19 The capital allowance for the OCTB refurbishment is included in the draft decision however the uplift in commercial revenues from this project had not been included within the forecast due to the link between the uplift in the rental charge payable by the Regulated Entity to daa group which has been disallowed in the opex forecast.

[redacted]In the final decision Dublin Airport request that the full rental charge for space occupied in DAC be reflected it the opex forecast and also the uplift in property income of [redacted] associated with the OCTB project. c. 55% of the space occupied in DAC relates to staff who have relocated from OCTB. The business case for the OCTB development has been updated to include this rental charge as incremental opex and the project still delivers [redacted]

Rolling incentives

6.3.21 The 2019 Determination maintained the rolling incentive scheme for commercial revenue to ensure Dublin Airport was incentivised to grow commercial revenues at all stages throughout the regulatory cycle. The application of a rolling scheme allows us to retain incremental revenues for a period of five years. The rolling incentive is based on a per passenger target for retail, car parking and advertising and a gross revenue scheme for commercial property.

6.3.22 Although the rolling incentive scheme was suspended for 2021, our view is that it remains an important regulatory tool that removes the potential distortions of a fixed length price control, ensuring that Dublin Airport has the same incentives to introduce commercial revenue innovations in year 1 or year 4 of the price control. This is particularly valuable in the context of a single till regulatory framework where the incentives to increase commercial

revenues are otherwise diluted. The rolling scheme should continue to apply in the next period.

6.3.23 We note the proposal to cap the outperformance subject to carry-forward at 10% of the target. Dublin Airport suggest that this cap is removed in the final decision to ensure the rolling incentive scheme would apply to more material initiatives above this 10% threshold. An example of an initiative that benefited from this rolling incentive scheme in the last regulatory period was [redacted] of Fast track. If the 10% cap was in place at that time the uplift relating to this commercial initiative would not have been included in the rolling incentive adjustment for the 2019 Determination.

6.4 Dublin Airport's Proposed Commercial Revenue Proposal for 2023-2026

6.4.1 Dublin Airport presented its commercial revenue forecasts for 2023-2026 in its 2022 Regulatory proposition where it projected total commercial revenues of [redacted] in 2023 increasing to [redacted] in 2026.

- **TABLE 6.4 DUBLIN AIRPORT COMMERCIAL REVENUE FORECAST 2023-2026**

[redacted]

6.4.2 Dublin Airport has prepared these forecasts on a bottom-up basis building on our expert knowledge of our commercial business, assessment of the unique set of challenges that we will face in 2023-26 and analysis of wider trends in each of our business segments, particularly any long-term changes as a result of COVID-19.

6.4.3 While these commercial revenues forecasts may be somewhat more conservative than the Commission's projections, we believe they represent a more realistic forecast of our likely revenue yields over the next regulatory period 2023-2026.

6.5 Conclusion

6.5.1 Dublin Airport believes that in the 2022 Draft Decision, the commercial revenue projections set by the Commission are based on ambitious revenue per passenger targets. Although there is no material divergence from Dublin Airport targets on a per passenger basis the passenger traffic forecast upon which the commercial revenue forecasts are based has resulted in an overly ambitious target.

6.5.2 The Commission's commercial revenue projections are underpinned by passenger traffic targets that are based on an unconstrained demand forecast which assumes that the airport has no capacity impediments for facilitating this growth. We believe that this makes the

Commission's commercial revenues highly ambitious and potentially unattainable for Dublin Airport to achieve over the period 2023-2026.

6.5.3 The Commission's final commercial revenue forecast needs to take account of the current falling consumer sentiment which is likely to negatively impact our commercial revenue yields going forward.

6.5.4 In addition, the Commission should maintain 2019 revenue per passenger as the baseline for its forecast rather than forecasting that any of the temporary market dynamics will continue.

6.5.5 Dublin Airport would request that in its final decision the Commission readjusts its current proposed commercial revenue targets to reflect more realistic passenger projections.

6.5.6 We believe that the combination of factors outlined above render the Commission's commercial revenues highly ambitious and potentially unachieveable over the period 2023-2026 thereby exposing Dublin Airport to further business risk.

Commercial Revenue Chapter Summary:

- In its 2022 draft decision, the Commission has set ambitious commercial revenue targets with total revenue forecast to grow from €281m in 2019 to €319m in 2026.
- Dublin Airport believes that in the 2022 Draft Decision, the commercial revenue projections set by the Commission are based on unattainable revenue per passenger targets.
- [redacted] As per our 2022 Regulatory Proposition, Dublin Airport has projected total commercial revenues of [redacted]
- The Commission's final commercial revenue forecast needs to take account of the current falling consumer sentiment which is likely to negatively impact our commercial revenue yields going forward.
- There are a number of supply-side constraints and capacity shortages that are likely to render revenue growth less responsive to passenger traffic increases.
- A number of factors have combined to render the Commission's commercial revenues highly ambitious and potentially difficult to achieve over the period 2023-2026 thereby exposing Dublin Airport to further business risk.

DublinAirport

Dublin Airport's response
CAR Draft Decision 2022

07
Cost of Capital

7. Cost of Capital

7.1 Introduction

7.1.1 Following the publication of the 2022 Draft Decision, NERA was asked by Dublin Airport to analyse the cost of capital proposals put forward by the Commission and Swiss Economics. We highlight their main findings in the discussion set out below and the full NERA report can be found in Appendix 2.

7.1.2 In the following section, we examine the approach taken by Swiss Economics in their derivation of their WACC proposal, we highlight what we consider are the flaws in this approach and we respond with our alternative WACC proposal for 2023-2026.

7.1.3 The following table sets out the empirical values for each of the WACC parameters put forward by the Commission and Dublin Airport.

TABLE 7.1 DUBLIN AIRPORT REQUESTED VS SWISS ECONOMICS WACC CALCULATION 2022

	DUB Reg Prop Approach 2		CAR/Swiss Economics DD	
Parameter	Lower Bound	Upper Bound	Lower Bound	Upper Bound
Gearing	50%	50%	45%	55%
Risk Free Rate	-0.94%	-0.60%	-1.59	0.54%
Total Market Returns	6.8%	7.0%	5.7%	6.81%
Equity Risk Premium	7.7%	7.6%	6.77%	7.87%
Asset Beta	*0.64*	*0.74*	0.52	0.59
Equity Beta	*1.28*	*1.48*	0.98	1.12
Cost of equity (after tax)	8.9%	10.6%	5.55%	7.65%
Cost of debt (pre - tax)	**-0.23%**	**0.00%**	-0.26%	0.14%
Pre-tax WACC (before aiming up)	4.97%	6.09%	3.35%	3.99%
Aiming up	0.5%	0.5%	0.5%	0.5%
Pre-tax WACC (post aiming up)	**5.47%**	**6.59%**	**3.87%**	**4.51%**

7.2 Context for the Cost of Capital Assessment

7.2.1 In setting the WACC allowance for 2023-2026, Dublin Airport is of the view that the Commission should have taken account of the following

- The impact of COVID-19 on Dublin Airport financials and more generally in the aviation market where it is widely accepted that aviation has now become a riskier industry.
- The recent cost of capital determinations by other regulators primarily the CAA H7 decision for Heathrow Airport which provided for a higher asset beta in the WACC allowance (compared to the previous Q6 determination) to reflect higher airport risk.
- The previous Commission cost of capital determinations (2014 and 2019) where the asset beta was calculated for a lower risk environment.
- The credibility of the Commission's current WACC proposal given that the 2022 Draft Decision is not proposing any risk sharing mechanism, it does not recognise the increased level of risk in the airport sector. Against this background, it is not tenable for the Commission to propose an asset beta for Dublin Airport which is lower than the asset beta for Heathrow Airport and lower than the value used in the Commission's own previous 2014 Determination.

7.2.2 In its 2022 Draft Decision, the Commission has proposed a real pre-tax weighted average cost of capital (WACC) of 4.22% for Dublin Airport over the period 2023-2026 based on a BBB+ credit rating. This proposal is based on a Cost of Capital study prepared by Swiss Economics on behalf of the Commission. In its analysis, Swiss Economics updated its original estimate of the WACC for Dublin Airport carried out in 2019. The Swiss Economics updated estimate of 4.22% for Dublin Airport is based on a cost of equity of 6.60% and a cost of debt of -0.10%.

7.2.3 Dublin Airport contends that a real cost of capital of 4.22% would provide an inadequate rate of return over the period 2023-2026 and this in turn would lead to a significant deterioration in the company's financeability over the next regulatory period.

Key shortcomings in Swiss Economics' Analysis

7.2.4 Dublin Airport believes that the Commission's recommendation of 4.22% is based on a WACC analysis provided by Swiss Economics which is flawed in relation to the following aspects:

- In its cost of equity estimate, Swiss Economics incorrectly derives its asset beta for Dublin Airport based on:
  a. A comparator set and risk assessment weighting scheme which is flawed, leading to undue reliance on airports with significantly lower risk.
  b. A selective use of data to estimate the asset beta which leads to a failure to recognise the impact that COVID has had on airports' betas.

- In its cost of debt estimate, Swiss Economics applies a flawed approach whereby:
  a. It fails to include issuance/debt transaction costs to the bank margin for embedded debt costs, which is inconsistent with regulatory precedent set by authorities such as the CMA.

b. It applies a forward uplift based on the European forward rate (instead of the Irish forward rate), which is incorrect as this fails to fully reflect Irish country risk in comparison to other high-rating Euro-area countries.

7.3 Dublin Airport's Response to the Commission's Cost of Capital Assessment

7.3.1 The main shortcomings in Swiss Economics' approach lie in the asset beta and cost of debt estimations. For each of these parameters, this section sets out the main methodological issues, how they produce under-estimates and our proposed revised approach to generate accurate estimates.

Issues with the Asset Beta estimation

1. Exclusion of Pandemic Data

7.3.2 In its updated 2022 report, Swiss Economics estimates its revised 2022 asset beta for Dublin Airport based on pre-pandemic data (prior to, and up to the end of 2019) and post-pandemic data (i.e. from the beginning of 2021 onwards). The exclusion of pandemic period data leads to significant underestimation of Dublin Airport's beta.

7.3.3 Swiss Economics stated that it excluded 2020 data in order to remove the distortions caused by the COVID-19 pandemic and it suggested that the co-movements between airports and stock indices had normalised by the end of 2020.

7.3.4 Given that the effects of the pandemic are ongoing, it is therefore appropriate that in the 2022 Interim Review, the Commission should take account of the current financial situation faced by the airport and include the 2020 data.

7.3.5 Swiss Economics decision was erroneous to exclude pandemic data on the basis that intervention by Irish government and the Commission has eliminated risk. NERA's analysis shows that the comparator airports also received government and regulatory support throughout the pandemic. This means that the empirical beta estimates of comparators already take into account the risk mitigating effects of government and regulatory support and are thus relevant to Dublin Airport.

7.3.6 We believe that Swiss Economics was wrong to conclude that the impact of the pandemic on beta risk is negligible, as market evidence shows an increase in beta from around 0.55 to 0.75 across Dublin Airport's comparator set during the pandemic period, and the betas are yet to return to pre-pandemic levels. We are concerned that if the Commission completely ignores the impact of traffic shocks when setting the regulatory WACC it will consistently underestimate the required rate of return.

7.3.7 Dublin Airport believes that the selective use of data by Swiss Economics amounts to second guessing 'real' investors' perceptions, which is inconsistent with best regulatory practice as the asset beta should be estimated based on market data.

7.3.8 Dublin Airport believes that the asset beta range of 0.52-0.59 estimated by Swiss Economics giving rise to the point estimate of 0.56 adopted by the Commission is significantly underestimated due to the above approach.

2. Sampling/Benchmarking Flaws

7.3.9 As per its 2019 study, Swiss Economics used a benchmarking exercise to establish empirical evidence to underpin its estimate for the asset beta for Dublin Airport. However, Dublin Airport believes that this benchmarking exercise is flawed and does not produce a reliable, accurate estimate of daa's beta and thus its WACC.

7.3.10 In its 2022 study, Swiss Economics used empirical evidence for 9 listed airports and regulatory decisions for unlisted airports. In deciding on these comparators, it used a weighting scheme that assigns scores to each comparator based on their comparability to Dublin Airport in regard to three risk categories (regulatory environment, demand structure and business structure).

7.3.11 For the listed airports, Swiss Economics then estimated the 1-year daily, 2-year daily and 5-year weekly betas against a European index (except for Auckland, Sydney and Turkish airports which are estimated based on the respective local indices).

7.3.12 The set of comparator airports is artificially large, comprising many poor comparators: Dublin Airport believes that the starting point for this benchmarking exercise is incorrect, as rather than seeking to identify the correct comparators with regards to the route and exposure to non-diversifiable risk, Swiss Economics has sought to identify the widest possible comparators set irrespective of their risk profile, to guard against the impact of potential outliers in the estimation. This then created a need to develop a mechanistic and artificial methodology to use all airports as part of the estimation process.

7.3.13 Redundant or irrelevant dimensions of systematic risk: We understand that the dimensions of systematic risk considered by Swiss Economics can, at times be redundant or even become a false indicator, and we are concerned that they are given undue importance in determining the asset beta for Dublin Airport. In this instance, Swiss Economics is implicitly assuming that the systematic risk is evenly distributed within the dimensions of comparability.

7.3.14 In our view there are several flaws implicit in this approach:

- A low proportion of commercial revenue of total source of revenue implies a high proportion of aeronautical income. It is well-established that aeronautical income,

generated through total number of passengers, is almost perfectly correlated with the economy's performance and therefore non-diversifiable risk.

- Furthermore, for those operators under a single till structure, the assessment of comparability to Dublin based on commercial revenue share is flawed - i.e. the single till approach overrides the source of income consideration.

Arbitrary choice of metrics and thresholds for comparability:

7.3.15 We believe that in some cases the metrics adopted (i.e. the origin of non-diversifiable risks) to assess the dimensions of systematic risk seem less relevant than others available for that dimension. Swiss Economics used the number of flights and passengers to estimate demand volume risks, but a better predictor of its volatility would have been the mix of flag vs low-cost carriers, or the mix of business vs leisure passengers**.**

7.3.16 In some cases, we believe that the threshold for the metrics adopted (i.e. the origin of non-diversifiable risks) to assess the dimensions of systematic risk seemed arbitrary. For example, Swiss Economics assumed that a 60% aeronautical revenue share qualified as comparable with Dublin Airport.

7.3.17 When comparator airports differed across the various dimensions identified by Swiss Economics, no attempt was made to estimate the direction and scale of any divergence from the Dublin Airport beta.

7.3.18 The poorer the comparator, the more overwhelmingly it tends to under-estimate Dublin Airport's beta. This would have shown that, for each characteristic except "stock listed vs regulator estimate" and "aeronautical revenue share", the effect is that lack of comparability with Dublin Airport implies that the beta observed for the comparator is an underestimate of our asset beta. With respect to "stock listed vs regulator estimate", the effect is unclear.

Unmitigated retention of outliers in the sample:

7.3.19 No attempt was made to explain the reasons for outliers in the sample used. As a consequence, we believe that each benchmark tended to underestimate the beta of Dublin Airport, all the more so the less comparable they were.

7.3.20 Excessive combined weight of poor comparators: The consequences of the flaws outlined in this approach are that:

- Almost half of the weighting of the current estimate (47.1%) derived is from airports that by Swiss Economics own assessment are poor comparators.
- Even the worst comparators (assessed with a comparability score of 3 out of 9) are given a 5.7% weighting, and marginally less poor comparators (4 out of 9) 7.5% weighting (By comparison, a higher quality benchmark - 6 out of 9 - only weighs 11.3%).
- While individually these appear 'light' enough weights, the combined effect is that 47.1% of the estimate is attributable to poor quality benchmarks.
- The lack of consideration of whether the sampled airports are more or less exposed to systematic risk than Dublin Airport does not enable the Commission to assess whether

Dublin Airport's asset beta is properly calibrated, and therefore whether the asset beta is under/overestimated.

Flawed assessment of comparators:

7.3.21 Notwithstanding our concerns set out above with the benchmarking methodology employed, Dublin Airport does not agree with the majority of comparators chosen by Swiss Economics on the following basis:

- Copenhagen and Auckland have unreliable total return data - only 1 per cent of Copenhagen airport's shares are listed, while Auckland trades on the poorly diversified NZX exchange (of which Auckland itself makes up 6 per cent of total market value). Both airports also have higher illiquidity than other comparators, as their share prices exhibit a bid-ask spread of 1 per cent or more.
- Sydney Airport is not subject to any formal price control, and is not located in the European market, making it a poor comparator for Dublin.
- Vienna Airport operates on a one-year price control regime, which is lower risk and not comparable to Dublin's multi-year framework. The UK CAA also excluded Vienna from its comparator set on the basis of the illiquidity of its stock.[36] We note that the UK CAA excluded both airports from its comparator set in its H7 Final Proposals. For Copenhagen, the UK CAA noted that: '*Given the very small proportion of free-floating shares at Copenhagen, which is materially lower than for our other comparators, we remain of the view that its beta cannot be estimated reliably, and we do not include it in either comparator set.'*[37] For Vienna, the CAA stated that: *'we continue to view Auckland's beta as unreliable due to the lack of diversity in the NZ index. We do not consider that the secondary listing on the Australian index would materially improve reliability, since secondary listings tend to be less liquid…We therefore continue to exclude this comparator from both comparator sets.'*[38]
- Fraport's price control framework exhibits flexibility regarding the length of the control period, making it lower risk than the Dublin Airport 4-year regulatory determination.
- For airports that are unlisted, Swiss Economics relies on regulatory beta estimates. We do not agree with the inclusion of Aeroporti di Roma and Gatwick Airport in the calculation of the 'post-pandemic' column in Table 16 of the Swiss Economics report, since these regulatory decisions were made prior to the pandemic and hence do not reflect the regulators' views on the post-pandemic betas. We note that their inclusion in this column brings down the average. If Gatwick is to be included, then Swiss Economics should at least uplift the beta by the same amount the CAA has for Heathrow (i.e. an uplift of 0.02 to 0.11). Furthermore, for Heathrow, based on Table 9.2 of the H7 final proposals, the pre-pandemic asset beta should be 0.50 (rather than 0.47) and the post-

[36] Ibid, para 9.70.
[37] CAA (2022) ,'Economic regulation of Heathrow Airport Limited: H7 Final Proposals, Section 3: Financial issues and implementation', June, para 9.71.
[38] Ibid.

pandemic beta should be 0.61 (the mid-point of the CAA's range for the beta, prior to adjusting for the impact of the traffic risk share mechanism).[39]

7.3.22 Full details of our expert advisor's concerns with these chosen benchmark airports are set out in the NERA report in Appendix 2.

Alternative approach:

7.3.23 A narrow sample of high-quality comparators: As an alternative NERA identifies a smaller comparator set comprising AENA, ADP and Zurich, which are the closest comparators in terms of beta risk because of their similar regulatory arrangement. All three airports operate under multi-year (e.g. 5-year) price caps that allocate volume and cost risk to the airport, which is the principal beta risk. Other risk factors – such as the composition of demand – are secondary.

7.3.24 There is strong regulatory precedent to support this approach where in its recent H7 regulatory decision for Heathrow Airport, the CAA's advisers set out similar criticisms of the use of the above comparators for an airport operating under an incentive based regulatory framework such as HAL and DAA, and as a result the CAA chose either not to use the above airports as comparators or to place less emphasis on their beta data.

7.3.25 We do not agree with Swiss Economics assertion that AENA and ADP as larger airport groups with a portfolio of airports renders them inappropriate comparators for Dublin Airport.

7.3.26 To the extent that AENA or ADP's greater size is a beta risk factor, it is likely that their greater size means that they display lower beta risk than Dublin Airport. NERA explains that in terms of the two comparators owning a portfolio of airports, the CAA considered this issue and found that the impact on the beta risk was uncertain. NERA also calculates that in the case of AENA and ADP that 80 per cent and 90 per cent of revenues respectively are generated from their main domestic airport, meaning their impact on the respective group betas is minimal.

7.3.27 Dublin Airport disagrees with the Swiss Economics assertion that their large comparator set reduces outlier effects, or the Commission's suggestion that a small comparator set could lead to a risk of idiosyncratic effects skewing Dublin Airport's beta estimate. Swiss Economics' approach of placing weight on all listed comparators has the effect of including low risk outliers. SE provides no evidence that NERA's estimates are affected by outlying observations. Indeed, there is broad consistency in comparator beta estimates for NERA's three comparators.

7.3.28 We noted that Swiss Economics previously used a narrower focussed comparator group to estimate beta in its January 2020 report prepared for French regulator ART which was similar to the current approach used by NERA for its estimation of the Dublin Airport beta. We

[39] Ibid, p. 36, Table 9.2.

question the reliability of the Swiss Economics' approach to estimating asset beta given that the flaws outlined above and the fact that, in a previous assignment for ART it had followed established best practice and, in this instance, it follows an approach that lacks economic basis.

3. No COVID-19 Uplift

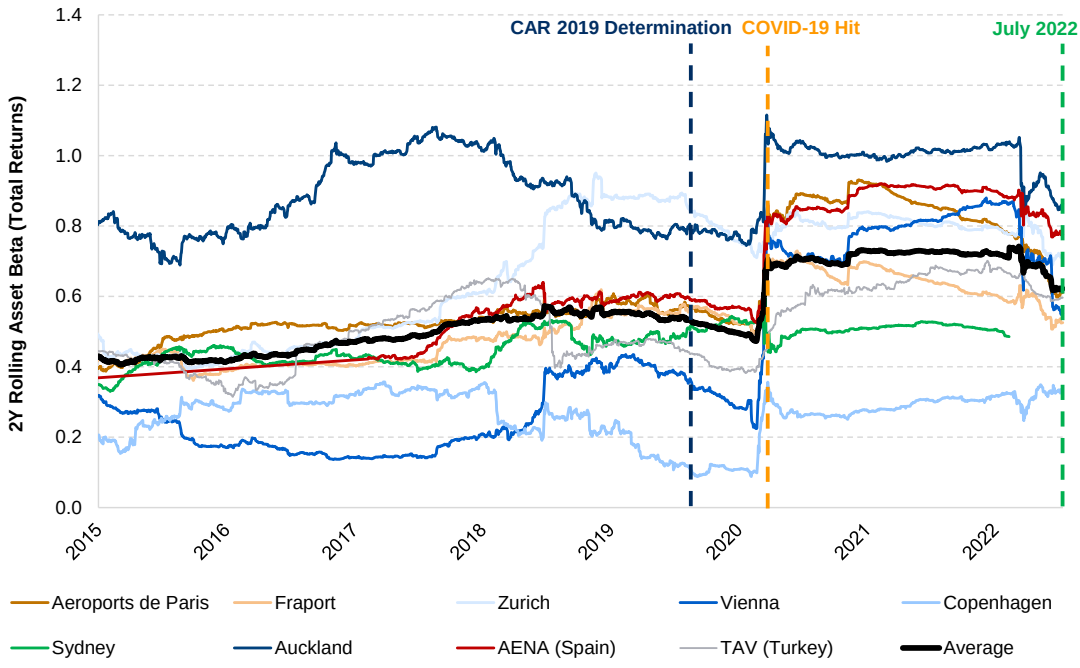
7.3.29 Swiss Economics did not add an uplift to reflect the possibility of future events similar to COVID-19 occurring and this was based on their view that:

- Government and regulators had provided measures to remedy the impact of COVID-19 and this would reduce uncertainty in the financial markets regarding future catastrophic events
- Events similar to COVID-19 are sufficiently rare to not be included in the estimation of beta
- The impact of COVID-19 on Dublin Airport's asset beta was low (0-0.04).

7.3.30 Our advisors, NERA, have a number of concerns with this approach

a. Empirical evidence suggests that betas for airports have increased since the pandemic and are yet to decline to pre-pandemic levels. As shown, there was an increase in beta from around 0.55 to 0.75 across the comparator set during the pandemic period, and the betas are yet to return to pre-pandemic levels.

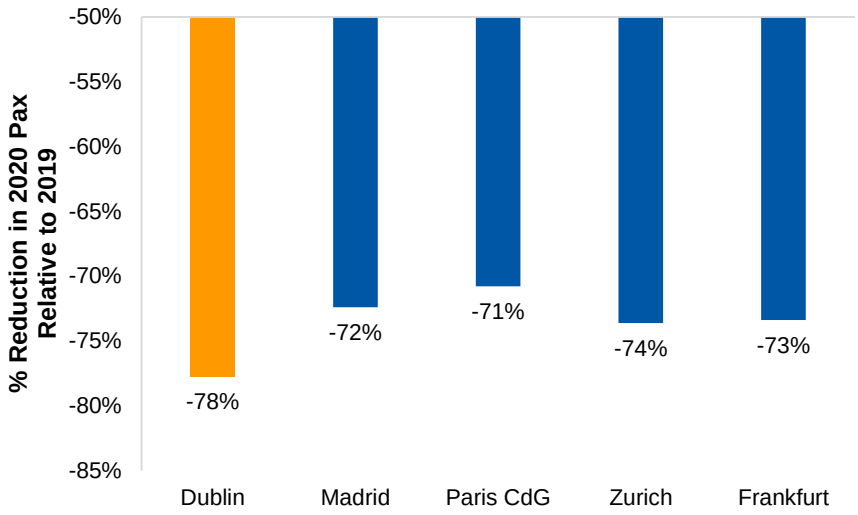
- **FIGURE 7.1 ROLLING ASSET BETA ANALYSIS**



(Source: NERA 2022)

b. Dublin Airport has faced greater peak-to-trough reduction in passengers during the COVID-19 pandemic than its comparators, suggesting higher beta risk. This is likely due to the fact that it has a higher proportion of international traffic compared to its comparator airports.

- **FIGURE 7.2 EUROPEAN PASSENGER REDUCTION 2019 VS 2020**



(Source: NERA Analysis)

c. Several comparator airports have also received COVID-19 mitigation measures and some have risk sharing mechanisms built into their regulatory framework. As a result of the disruption caused by COVID-19, several regulators have implemented mitigation measures designed to support airports, either immediately allowing some relief or proposing changes for the next regulatory period designed to compensate the pandemic shortfall. In particular, AENA, ADP and Zurich all received substantive government support and regulatory resets, therefore their empirical beta estimates already take into account these risk mitigations.

d. The risk of future pandemics and events posing similar risks to the airport industry should not be ignored. For example, on the 23rd July 2022, WHO declared the highest alert over the current monkeypox outbreak and Europe has been singled out as the only global region where the risk of monkeypox is high.[40]

e. We disagree with the assertion that the impact of COVID-19 on Dublin Airport's asset beta was low (0-0.04), given that we estimate that a 0.01 increase in the asset beta translates into c10bps in the WACC.

Revised Estimation of the Asset Beta

[40] World Health Organization (23 July 2022), Second meeting of the International Health Regulations (2005) (IHR) Emergency Committee regarding the multi-country outbreak of monkeypox.

7.3.31 As an alternative to the Swiss Economics estimation of the asset beta, NERA have proposed two alternative approaches to the calculation of the asset beta for Dublin Airport for 2023-2026. These approaches are consistent with the methodology proposed in the NERA April cost of capital report for Dublin Airport.

7.3.32 Approach 1, where NERA relies on the most recent estimates of asset betas as of the cut-off date (12 July 2022), with no adjustment or weight given to solely pre-COVID estimates or approach 2, where NERA applies the methodology used by CAA in the H7 regulatory review for Heathrow Airport.

7.3.33 Under approach 1, weight is placed on the most recent estimates of asset betas, with no adjustment or weight given to solely pre-COVID-19 estimates. The rationale for using current estimates is that there is still uncertainty around COVID-19 risks, and investors' perception of risk has changed. Also, Dublin Airport was not compensated for pandemic related risks at previous price controls – relying on pre-pandemic betas would mean these risks were ignored to date and would be largely ignored in the future as well. Following this approach, NERA estimated an asset beta range of 0.70-0.78, based on the average 2-year and 5-year empirical asset beta estimates of close comparators (AENA, AdP and Zurich).

7.3.34 Under approach 2, NERA applied the CAA's estimate of pandemic uplift (0.02-0.11) which reflects the increase in asset beta due to pandemic risk to its assessment of Dublin Airport's pre-pandemic asset beta of 0.6. Under this approach, NERA estimated an asset beta range of 0.62 to 0.71. This approach draws on the asset beta for Dublin Airport in "normal times" while also explicitly accounting for pandemic risk events.

7.3.35 In its recent Final Proposals, the CAA estimates that Heathrow Airport's asset beta (pre volume risk sharing adjustment) is 0.52-0.71 with a point estimate of 0.61.

7.3.36 Given the similar regulatory framework but significantly different (and non-diversifiable) market risk, the 0.61point estimate should represent the floor of Dublin Airport's asset beta range.

7.3.37 Heathrow's pre-volume risk sharing adjustment asset beta should represent the floor of Dublin Airport's asset beta range as the Commission's Draft Decision does not provide for volume risk sharing arrangements nor is it currently allowing for a RAB adjustment to recoup pandemic losses.

7.3.38 In addition, it should be noted that Dublin Airport's market risk is greater than Heathrow's, therefore by definition its asset beta must be greater. While both airports operate under very similar regulatory frameworks, their demand characteristics are quite different:

- C.70% of passengers at Dublin are carried by just two operators.
- Low-cost carriers at Dublin Airport represent c.51%; no low-cost carriers operate from Heathrow.

- Low-cost passengers' demand is more elastic than full-service carriers'.
- Passenger volumes are closely linked to the economic environment; given the more elastic nature of passenger demand at Dublin Airport, it is more exposed to economic downturns.
- Dublin Airport operates a point-to-point network, whereas Heathrow Airport operates as a hub. Being a hub airport provides additional demand risk protection (ie. airlines can concentrate routes to optimise operation and airlines feed each other).
- Heathrow has experienced excess demand for almost a decade ahead of the pandemic. There is significant pent-up demand which would lead to a faster recovery and the potential to be capacity constrained again, offering greater demand risk protection.
- London is a larger tourist and business destination than Dublin.
- Carriers serve more diverse destinations at Heathrow Airport than Dublin: a combination of primary cities, secondary and holiday destinations.

7.3.39 Dublin Airport has no certainty about how the Commission would decide to exercise its discretion to support the airport in the event of a pandemic. But if we were to extrapolate based on the support provided throughout COVID-19, a redetermination would only happen 3 years after the start of the crisis and the protection likely to be provided would be minimum.

7.3.40 In the absence of clarity on how the Commission would intervene to protect the airport, Dublin Airport remains exposed to considerable market risk.

7.3.41 Dublin Airport has adopted approach 2 set out by NERA and on this basis, we propose that the correct asset beta should sit in the range 0.62-0.71 based on market evidence and the precedent that the CAA's decision on Heathrow sets.

Issues with the Estimation of the Cost of Debt

7.3.42 Swiss Economics' approach to estimating the cost of debt in its 2022 report is based on a weighted average of the cost of embedded debt and new debt for a notional investment grade credit rating. The cost of new debt is based on a notional rating of BBB+, using yields on the iBoxx EUR BBB-rated benchmark index with maturities of 10+ years, with an average time to maturity of 14 years.

7.3.43 Swiss Economics then adjusts this yield upwards for a forward rate uplift, plus issuance costs of 10 bps, and adjusted for the spread between BBB and BBB+ credit rating of between 7 and 13 basis points. It chooses to use a European forward rate rather than an Irish rate. Based on this approach, Swiss Economics calculates the cost of debt allowance for Dublin Airport to be -0.31 to 0.11 per cent, with a central estimate of -0.10 per cent (assuming a BBB+ credit rating).

7.3.44 NERA carried out a review of the Swiss Economics estimation of the cost of debt for Dublin Airport and it concluded that the approach they used was flawed based on the following:

a. Swiss Economics fails to include issuance/debt transaction costs to the bank margin for embedded debt costs, which is inconsistent with regulatory precedent set by authorities such as the CMA.

b. Swiss Economics applied a forward uplift based on the European forward rate (instead of the Irish forward rate), which is incorrect as it fails to fully reflect Irish country risk in comparison to other high-rating Euro-area countries.

Revised Estimation of the Cost of Debt

7.3.45 NERA calculated Dublin Airport's cost of embedded debt based on data on outstanding debt provided by Dublin Airport. They calculated an average cost of debt across all issues in daa's debt book, weighted by the principal amount and deflated using ECB long-term inflation expectations. NERA estimated the embedded cost of debt for Dublin Airport as -0.46 per cent in real terms.

7.3.46 NERA used a similar approach to Swiss Economics when estimating the cost of new debt, by relying on iBoxx EUR non-financial corporate bond 10+ year yields and applying an adjustment to the BBB+ corporate debt.

7.3.47 NERA set lower and upper bounds to the cost of new debt based on the highest and lowest iBoxx index historical averages by period length (NERA based the lower and upper bounds on the minimum and maximum of the 1-year, 2-year and 5-year average iBoxx yield). NERA also included an uplift to the BBB-rating cost of new debt to reflect the Irish forward rate. This is in contrast to Swiss Economics who incorrectly used a European forward rate.

7.3.48 Based on the above approach, NERA estimated a BBB real cost of new debt of 1.05 to 1.44 per cent.

7.3.49 NERA then adjusted this BBB-rated cost of new debt to reflect DAA's BBB+ rating, by estimating the spread between BBB+ and BBB ratings based on the spread between the iBoxx non-financial corporates 10+ index for A-rated debt and BBB-rated debt. This in turn resulted in an estimated Dublin Airport BBB+ real cost of new debt of 0.98 to 1.18 per cent.

7.3.50 NERA then calculated Dublin Airport's overall cost of debt allowance for 2023-2026 based on their estimates of the company's cost of embedded debt and cost of new debt. NERA combined the two estimates based on the average expected share of new debt across all four years in the 2023-2026 period (this was 26% on average over this period).

7.3.51 NERA then added a transaction cost of 10-20 basis points to their cost of debt estimates, to reflect regulatory precedent from the CAA, CMA and Ofgem. This resulted in an estimated total cost of debt for Dublin Airport of -0.08-0.14 per cent for the period 2023-2026.

7.4 Dublin Airport's Proposed Cost of Capital for 2023-2026

7.4.1 NERA combined their cost of equity estimates with their cost of debt estimate and their notional gearing assumption of 50 per cent, to develop two ranges for Dublin Airport's cost of capital for the period 2023-2026.

a. A cost of capital of 5.9-6.7 per cent based on current beta estimates (approach 1) or

b. A cost of capital of 5.3-6.2 per cent based on a pre-pandemic beta including an uplift for future events similar to COVID-19 (approach 2).

Table 7.2 NERA WACC calculation 2022

	Approach 1: Current beta estimates		**Approach 2: Pre-COVID BETA 0.6+uplift (0.02-0.11)**	
Parameter	Lower Bound	Upper Bound	**Lower Bound**	**Upper Bound**
Gearing	50%	50%	50%	50%
Risk Free Rate	-0.07%	0.30%	-0.07%	0.30%
Total Market Returns	6.75%	7.00%	6.75%	7.00%
Equity Risk Premium	6.82%	6.70%	6.82%	7.00%
Asset Beta	*0.70*	*0.78*	0.62	0.71
Equity Beta	*1.40*	*1.56*	1.24	1.42
Cost of equity (after tax)	9.48%	10.75%	8.39%	9.81%
Cost of debt (pre - tax)	**-0.08%**	**0.14%**	**-0.08%**	**0.14%**
Pre-tax WACC (before aiming up)	**5.38%**	**6.21%**	**4.76%**	**5.68%**
Aiming up	0.5%	0.5%	0.5%	0.5%
Pre-tax WACC (post aiming up)	**5.88%**	**6.71%**	**5.26%**	**6.18%**

(Source: NERA Analysis)

7.4.2 While Dublin Airport believes that approach 1 proposed by NERA is methodologically superior and it would provide the optimal outcome in terms of a WACC range of 5.9-6.7 per cent, we are willing to accept a range of 5.3-6.2 per cent proposed under NERA's alternative approach 2 as a minimum. We are endorsing this lower range in the interests of fairness and balance for the aviation sector as a whole when computationally progressed through the Commission's building block model.

7.5 Conclusion

7.5.1 In response to the Commission's 2022 Draft Decision, NERA carried out a review of the Commission's proposed cost of capital allowance, full details of which are contained in Appendix 2. This review identified a number of errors and flaws in the Swiss Economics

methodology which was used by the Commission in its proposed WACC allowance for Dublin Airport over the period 2023-2026.

7.5.2 In its calculation of the asset beta in the cost of equity for Dublin Airport, Swiss Economics used a flawed approach where:

- It excluded 2020 pandemic data from its calculation.
- It used too broad a comparator set and risk assessment weighting scheme, leading to undue reliance on airports with significantly lower risk.
- It failed to provide for a COVID-19 uplift to the "non-pandemic" beta estimate.
- It did not place significant weight on the CAA's estimate of Heathrow's asset beta (pre volume risk sharing adjustment) as a floor for Dublin Airport's beta, given the greater market risk arising from the different characteristics of Dublin Airport's demand.

7.5.3 In its calculation of the cost of debt for Dublin Airport, Swiss Economics used a flawed approach where:

- It failed to include issuance/debt transaction costs to the bank margin for embedded debt costs, which is inconsistent with regulatory precedent set by authorities such as the CMA.
- It applied a forward uplift based on the European forward rate (instead of the Irish forward rate). This is incorrect as it fails to fully reflect Irish country risk in comparison to other high-rating Euro-area countries.

7.5.4 Based on the expert analysis provided by NERA set out in Appendix 2, Dublin Airport is proposing that the appropriate cost of capital allowance for Dublin Airport for 2023-2026. Is in the range of 5.26% to 6.18% [41]

7.5.5 This cost of capital range includes an aiming up component of 0.50%, this is similar to the aiming up allowance currently included in the Commission /Swiss Economics WACC estimate.

7.5.6 Dublin Airport agrees with the Swiss Economics proposition that an aiming up allowance in the WACC is prudent and necessary given the following factors:

- The scale of Dublin Airport's revised CIP 2020+, combined with other ongoing capital projects.
- Regulatory precedent in Ireland and the UK has implicitly and explicitly included 'aiming up' components.
- The current level of high risk and uncertainty impacting the air transport sector.

7.5.7 Dublin Airport notes that the Commission has identified the need for a financeability adjustment over the period 2023-2026 and it is proposing to use accelerated deprecation as a means of addressing this issue. However, we believe that in the interest of best regulatory practice, the Commission should be looking to ensure an adequate rate of return for the

[41] Based on NERA's approach 2 to the calculation of the asset beta.

regulated entity rather than resorting to a financeabilty adjustment as we have outlined in our Financeability chapter.

7.5.8 It is vitally important that an appropriate cost of capital estimate be put in place for the period 2023-2026 as this will ultimately underpin the financial viability of the regulated entity.

Cost of Capital Chapter Summary:

- In response to the Commission's 2022 Draft Decision, NERA carried out a review of the Commission's proposed cost of capital allowance. This review identified a number of errors and flaws in the Swiss Economics methodology which was used by the Commission in its proposed WACC allowance for Dublin Airport over the period 2023-2026.
- We believe that a correction of the errors and flaws in the Swiss Economics study will lead to a higher WACC allowance for Dublin Airport.
- We believe that a more realistic WACC allowance in the range of 5.26% to 6.18% is required for 2023-2026 at a minimum.
- An adequate rate of return for the regulated entity for 2023-2026 is the only economically sound alternative the Commission has to ensure the viability of the regulated entity.

DublinAirport

Dublin Airport's response CAR Draft Decision 2022

08 Capital Costs

8. Capital Costs

8.1 Introduction

8.1.1 Dublin Airport welcomes the 2022 Draft Decision from the Commission in respect of capital costs for the period 2023-2026.

TABLE 8.1 CAPITAL COST 2023-2026

	2023	2024	2025	2026
Return on Capital(€m)	92.5	102.8	112.5	122.8
Return of Capital (€m)	105.5	124.9	139.5	160.0
Return of Capital (€m) (extra depreciation)	21.1	18.6	14.3	7.0
Total (€m)	219.1	246.3	266.3	289.8

(Source: CAR, Dublin Airport)

8.1.2 Dublin Airport strives to ensure that it maintains and renews its capital assets on an ongoing basis in order to meet the requirements of its airport users.

8.1.3 We remain committed to our medium-term goal of developing the airport capacity and infrastructure to deal with 40 million passengers per annum as set out in our revised Capital Investment Programme (CIP2020+).

8.2 Context for the Capital Cost Assessment

8.2.1 Dublin Airport believes that, in setting its capital expenditure allowance for 2023-2026, it is important that the Commission is cognisant of the following:

- The importance of a full capital allowance to enable a timely delivery of necessary airport investment in the aftermath of the COVID-19 pandemic.
- The importance in allowing for a regulatory framework that will facilitate rather than hinder commercially oriented investment in accordance with the needs of the airport and the requirements of its airlines.
- The importance of including appropriate mechanisms that will enable the airport to efficiently develop investment in the context of escalating construction inflation costs and other constraints in the supply chain.

8.2.2 While Dublin Airport is supportive of the Commission's approach to the roll forward of our current RAB and the calculation for the opening RAB for 2023[42] we believe that given that the regulated entity experienced severe losses in revenue in 2020 and 2021 due to COVID-19 a specific adjustment in the opening RAB for 2023 should have been included to allow for the

[42] We do however have questions in regard to potential errors in the methodology underpinning the opening RAB, these are set out in appendix 5.

recovery of a portion of these unrecovered operating costs and debt costs over the period 2023-2026.

8.2.3 As part of our 2022 Regulatory Proposition, Dublin Airport submitted a revised CIP2020+ where following consultation with our airport users, we set out our capital investment plans for 2023-2026.

8.2.4 We welcome the fact that the Commission is supportive of the revised CIP+2020 and that the Commission is proposing to provide an allowance for the projects set out in this investment programme with the exception of the Drop-off Pick-up project.

8.2.5 In respect of investment over the period 2023-2026, the Commission has reintroduced a number of capital investment triggers in the price cap formula. We are disappointed to see the return of the capital cost triggers, as we consider that this will potentially hamper development of greatly needed infrastructure at the airport going forward.

8.2.6 Dublin Airport is disappointed that the pro-rata treatment proposed in our 2022 Regulatory Proposition for capital investment has not been accepted by the Commission in its 2022 Draft Decision.

8.2.7 Given the current escalating costs in the Irish construction sector, we are extremely concerned and surprised that a mechanism to allow for construction inflation has not been permitted in this Draft Decision, given that this is a serious and significant factor that could threaten our overall CIP delivery.

Dublin Airport's Response to the Commission's Capital Cost Assessment

8.2.8 In the following section we set out a number of concerns which Dublin Airport has in regard to certain aspects of the Commission's proposed treatment of capital costs for 2023-2026.

2019-2022 RAB Reconciliation

Underinvestment 2019 to Present

8.2.9 While Dublin Airport accepts that it is currently below the pro-rated allowance for the period 2020-2022, we were however experiencing COVID-19 during the majority of this period and, for two years, we were subject to a very restrictive interim review process that required majority approval for projects >€4m. We also felt that it was inappropriate to undertake substantial capex at a time when our passenger traffic was down 70%. This greatly restricts our ability to deliver to the capital schedule proposed in 2019 and this should be considered

in this context. However, assets will continue to degrade during the period 2023-2026. Dublin Airport asserts that extra spending will be required to recover this period of under-investment enforced by COVID-19 and the restrictive capital approval process. Adding an extra two years to the forthcoming regulatory period will also require higher spending on Core projects.

8.2.10 Based on the above, Dublin Airport requests the Commission reconsiders its proposed capital expenditure allowances for 2023-2026.

South Apron PBZ Remuneration

8.2.11 In regard to the remuneration of the south apron PBZ delivered as part of the PACE suite of projects, Dublin Airport should be remunerated for this asset for the time it is used. This asset will be utilised fully pending the delivery of Pier 5, therefore, as such, it should be remunerated pro-rata to the asset life of the asset. The PBZ was delivered to deal with rapidly increasing passenger numbers in the South Apron and is required to bridge the gap between the current operation and the South Apron development. The PBZ will continue to be fully utilised in its current location and operation. Therefore, a capital allowance for the period it is in operation should be included in the RAB.

8.2.12 The PBZ project was originally submitted with an asset life of 20 years but was subsequently assigned an asset life of 40 years by the Commission, which is a disproportionally long asset life for this type of structure. We believe that a 20-year asset life would be more appropriate. Pier 5 will not be operational until Q3 2029; we propose that the PBZ is allowed to be remunerated until Pier 5 is operational. The value is the pro-rata of the asset life of 20 years used until Pier 5 is operational. The PBZ was constructed in Q1 2017, and Pier 5 is due to be handed over in Q3 2029, which is circa 13 years of beneficial asset use. This would be from the date of construction of the PBZ until the date Pier 5 trigger B is activated. Since submitting the CIP 2020+ review, Dublin Airport has received full permanent planning permission from Fingal County Council for the PBZ. This allows the PBZ to remain active and utilised independently of the timelines of other developments in the South Apron. The PBZ is essential to Dublin Airport, facilitating the recovery in passenger numbers post COVID-19. It also plays a key role in maintaining passenger numbers through this regulatory period while other infrastructure is being delivered that will reduce capacity elsewhere on the apron.

8.2.13 Based on the above, Dublin Airport requests that the Commission considers the full remuneration of the PBZ project.

HBS Projects Allowances

8.2.14 The remuneration of the IFS recommended StageGate 1 allowance for the HBS projects, as outlined by the Commission is welcomed by Dublin Airport. This reinforces the role of the IFS as the independent arbitrators of efficient capital expenditure for complex projects. We

will continue to work with the process to deliver the best outcomes on projects for airport users.

2023-2026 Capital Allowances – CIP2020+ Review

Pro-rata Core treatment

8.2.15 In its 2022 Draft Decision, the Commission has proposed that it will not allow pro-rata treatment for 'core' capital expenditure in 2025 and 2026. The Commission has questioned whether the scale of this investment can be delivered by Dublin Airport and it has suggested that there is no crystallised scope for these projects as they are not defined. The Commission has proposed that Dublin Airport can seek an additional allowance if the grouped allowances are insufficient using the in-period mechanisms. However, in the intervening period between the submission of the CIP 2020+ Review report and now, projects envisaged for the pro-rata treatment have crystallised. Therefore, Dublin Airport is now submitting seven new and updated Core project sheets in Appendix 3 of this submission for consideration. These projects comprise of five updated and two new "Typical" Core projects now required in place of the initially proposed and disallowed pro-rata treatment to cover additional requirements over the extended CIP period out to 2026, which in effect represents an extension of two years over the original 2019 CIP submission. They have a combined value of €90.7m this only includes the new scope and costs for extended projects.

8.2.16 As the years 2025 and 2026 fall outside the 2019 determination period, areas of the airfield will be added that have deteriorated to a condition that requires rehabilitation from the assessment made in 2019. These areas have been identified and are presented as extra areas of apron and taxiway for rehabilitation presented by updates to the Apron Rehabilitation Programme (CIP.20.01.002) and Airfield Taxiway Rehabilitation Programme (CIP.20.01.003).

8.2.17 Since the CIP 2020+ Review submission, Dublin Airport has reviewed the campus-wide airfield and apron maintenance, FOD and snow clearing vehicle storage strategy and sees synergies and efficiencies in combing the two fleets into a single vehicle store at the Airfield Maintenance Base. The updated Airfield Maintenance Base Improvement Programme project (CIP.20.01.016) proposes the development of additional space to include storage of the apron snow vehicle fleet during the summer period.

8.2.18 The updated AVDGS project (CIP.20.01.074) is to continue with the installation of this equipment on all stands at the airport. This will give operational efficiency and safety and allow us to get the most from available stands. This will also help with our sustainability agenda by reducing on stand time and taxiway idling.

8.2.19 The updated Programme Management (Portfolio Office) project (CIP.20.07.001) is to organise and deliver this unprecedented collection of projects so that the airport has minimal

disruption. This project is essential to ensure the delivery of the overall CIP and for the airport to ensure the outcomes of the projects are as envisaged.

8.2.20 The new Airfield Optimisation project (CIP.20.01.100) is a collection of projects to improve airfield operation. These multiple airfield optimisation projects are required to ensure consistency across the airfield, improve airfield operational, maintain safety and maintain good public relationships with our local community. All these projects are now required, given the extended CIP period to 2026 and can no longer be deferred. The projects include relocation of runway and taxiway hold points and guard lights, removing derelict buildings, and installing airfield AGL chamber lift manholes.

8.2.21 The new West Apron Cargo Handling project (CIP.20.01.101) proposed to address the main challenges outlined to Dublin Airport by all operators and to support companies due to the closure of the surface crossing in the interim while also providing much-needed additional facilities in the medium term. Without this new infrastructure, there is a natural and clear risk to the viability of the west apron operation and financial and reputational loss to Dublin Airport and the Western Apron operators. There are also knock-on impacts to the wider Irish export market. In a recent interview with Fleet.ie, Aidan Flynn CEO of Freight Transport Association Ireland (FTAI) outlined his concern:

"Express services are located on the west apron at Dublin Airport: the opening of the new runway has blocked the direct access to these terminals and support services, as the West Apron Surface Crossing has been closed. Closure of the direct access to the freight operators' airside operations will create significant logistics issues that are not easily resolved. Logistics operations already face significant time pressures in loading and offloading flights and efficiency is key. The previous access to the airport enabled loading and unloading to take place in approximately 10 minutes; the new proposed route along the north perimeter road is 8km long and will take over 30minutes for each journey. FTAI is calling on Dublin Airport Authority to expediate the development of the promised underpass and review the necessary standard of support services, including office accommodation."

8.2.22 Dublin Airport does not consider the flexibility of the T1 façade as being sufficient to replace the disallowing of the pro-rata allowance. That is why several updated and additional project sheets are being submitted to fund vital projects that have crystallised since the submission of the CIP. Dublin Airport also considers that projects changed from Deliverable to Flexible in the CIP submission are essential to give delivery flexibility to the asset management team.

8.2.23 Dublin Airport requests that the Commission considers these new and updated project sheets as outlined above.

Construction Inflation Treatment

8.2.24 In its 2022 Draft Decision, the Commission has proposed that a construction inflation adjustment mechanism is not required for 2023-2026. Dublin Airport would like to reiterate the very strong need for this mechanism to navigate this very uncertain time for construction

pricing in Ireland. The Commission has outlined the CPI inflation adjustment mechanism that will be made concerning real prices for projects and the difference between the TPI projection and CPI being allowed for in the Draft Decision.

8.2.25 However, the projection of TPI made by Dublin Airport depended on the adjustment mechanism allowed for, as this would in turn lower the risk profile of inflation for projects. This was outlined in the CIP 2020+ Review document submitted to the Commission. In the absence of this mechanism, Dublin Airport will need to change the TPI projection, as the risk for the adjustment between CPI and TPI is now fully borne by Dublin Airport. Historically, there has been no direct link between TPI and CPI and the risk that these indexes could diverge is high. It was outlined in our CIP 2020+ review submission that this would be required in the absence of the adjustment mechanism. Therefore, Dublin Airport proposes to alter the projected TPI inflation to 12% for 2022 (SCSI TPI inflation for the first 8 months is circa 9%), 8% for 2023, 6% between 2024 to 2026 and 4% from there on. This is to reflect market sentiment that inflation will run high for the next 2 years and then start to tail off from 2024 as supply chains and energy markets realign. As there is no mechanism now to adjust to actual TPI throughout the determination period Dublin Airport must now adjust project costs to reflect the most up to date inflation projections. Dublin Airport will submit updated Level 3 cost estimates for all projects to reflect this new inflation projection. Dublin Airport will also submit updated core project inflation project projections. These will be reviewed by the IFS and the Commission.

8.2.26 The addition of the new inflation profile to reflect the removal of the TPI adjustment mechanism has changed the overall CIP ask to €3.28bn from €2.74bn. This is a sizable adjustment but is fundamentally reflective of the hyper-inflation seen in the market and the unpredictability of the current market. In the absence of the proposed adjustment mechanism this is the new total cost projected by Dublin Airport. If inflation is lower than projected, Dublin Airport will return this to airport users by delivering the projects at lower costs than projected.

8.2.27 In the Draft Decision the Commission has proposed that a possible response to the current inflation pressure is to elongate delivery timelines of projects to offset the inflationary increase. However, it is doubtful that inflation will reverse into a deflationary cycle during this CIP period. The gains in prices during this inflation period will be retained in subsequent years after inflation returns to a normal range. This means that increasing the timelines of projects will only increase the cost of delivering projects overall. Therefore, there is nothing to be gained in increasing the timelines for individual projects, except, perhaps, greater certainty in prices in a period with normal inflation and reducing the outgoings in a particular period. The programmes given are deliverable depending on planning permission, regulatory approvals and resourcing levels available in the Irish economy.

8.2.28 Based on the above, Dublin Airport requests that the Commission reconsiders the inclusion of a construction price inflation adjustment mechanism for 2023-2026.

Asset Life Adjustments

8.2.29 The Commission has proposed adjustments to a number of asset lives put forward by Dublin Airport. Dublin Airport would like to challenge the basis for some of the proposed changes to these asset lives. The Commission has proposed changing the asset life for Taxiway Romeo to 30 years from 20 years. Dublin Airport would challenge this adjustment on the basis that most of the works associated with Taxiway Romeo will be pavement rehabilitation and widening as opposed to new pavement construction. These works will be primarily completed in asphalt, which requires a significant intervention after 20 years of service. The asset life for the Apron and Taxiway rehabilitation projects is 20 years, and Taxiway Romeo should be 20 years to align with these projects.

8.2.30 An asset life of 30 years is too long for the de-flex project on Pier 4. These corridors will not have a life of 30 years without replacement or major refurbishment within this 30-year period. This means that they cannot function economically over a 30-year period and should be reduced to 20 years to reflect this. This will align the life of the asset to major asset intervention.

8.2.31 The IFS, in their efficiency assessment review of the CIP commented that the asset life of 20 years for projects CIP.20.04.003 – New Food & Beverage Fitout (Table 6.17), CIP.20.04.023 – Food & Beverage Provision & Fitout – Post CBP (Table 6.81) and CIP.20.04.030 – New Kitchen in Terminal 2 (Table 6.96) is too long based on retail and F&B trends. The trends in the F&B sector are such that it would be doubtful that an outlet concept would last 20 years and that replacing it after ten years would make better commercial sense as it would give a better return on the investment. Therefore, Dublin Airport wants to set the asset life to ten years for these projects to accurately reflect the reality of the F&B commercial cycle.

8.2.32 Based on the above, Dublin Airport requests that the Commission reconsiders the proposed changes to the asset lives of the specified assets.

Trigger Projects

8.2.33 All projects subject to the Infrastructure Application (IA) are included in the proposed trigger system proposed by the Commission. The Commission has requested responses from stakeholders as to the make-up of the list of projects subject to triggers. Dublin Airport would propose that no new projects should be added to the current list. All other projects are not subject to the IA and do not have the same delivery timeline risk as these projects. They will only require standard planning applications without the complications of the IA. In addition, it would be consistent with removing the CBP project from the list of trigger projects and including it in the basic passenger charge calculation. In a recent meeting with Fingal County Council, it was decided that this project could be submitted as a standalone project not dependent on the IA. This reduces the timeline risk for the delivery of this project within the current CIP period.

8.2.34 Concerning the Commission's request for comment on the addition of the underpass project to the trigger projects, Dublin Airport asserts that this project should not be part of the trigger projects as it has a separate planning permission process to these projects. This project will proceed through the normal planning process with much lower risk than the IA projects. The project has also been extensively designed to date and can start construction soon after granting of planning permission. This project is also required to adequately service the West Apron operation with the North Runway becoming operational. It was also shown in paragraph 8.2.19 that the freight community require the construction of this underpass as soon as possible.

8.2.35 Based on the above, Dublin Airport requests that the Commission reconsiders its approach to trigger projects for 2023-2026.

8.3 Dublin Airport's Proposal re Capital Costs for 2023-2026

RAB Reconciliation

8.3.1 As previously outlined, Dublin Airport experienced severe losses in revenue in 2020 and 2021 as a result of the pandemic. This implied that Dublin Airport was unable to recover its operating expenditure, nor was it permitted to earn the level of revenue required to recover depreciation, debt costs and a return for equity investors. This was unprecedented and the revenue impact of this demand side shock has had a substantial negative impact on the Dublin Airport balance sheet.

8.3.2 While we understand that this was a crisis that could not have been foreseen that affected the entire aviation industry, we believe that going forward it would be appropriate if not necessary for the Commission to make a RAB adjustment to aid financeability and ensure the credibility of the RAB going forward.

8.3.3 We proposed that the Commission should undertake a RAB reconciliation as part of the 2022 regulatory review where the revenue losses in 2020-22 resulting from COVID-19 (in particular, unrecovered operating costs and debt costs) should be recoverable in future periods via a specific adjustment in the opening RAB for 2023.

8.3.4 We noted that there is regulatory precedent[43] to support such a measure given that as part of the H7 regulatory review the CAA has already introduced an explicit RAB adjustment to allow Heathrow Airport to remain financeable and to ensure the credibility of the RAB.

[43] In the Thessaloniki Forum paper on Cost Recovery, it was acknowledged that as a result of the impact of the COVID-19 pandemic on the aviation industry, most ISAs took actions under "exceptional circumstances". It reported that these actions taken in relation to the COVID-19 pandemic varied considerably, where some

8.3.5 If the Commission were to adopt such a RAB adjustment this would have the benefit of addressing the current financeability shortfall without the need for a recourse for accelerated depreciation while providing airport investors with the confidence that they will be able to recover their investments, and ultimately leading to a reduction in the cost of capital.

8.3.6 It is therefore clear, that given our current circumstances in the aftermath of the COVID-19 pandemic there is regulatory precedent and acceptance among regulators as to the need for appropriate regulatory interventions to aid recovery in the airport sector during this time of crisis.

8.3.7 On this basis, we call on the Commission to reconsider in its Final Decision the possible inclusion of a RAB adjustment.

Quarterly reporting

8.3.8 In response to the requirement for the continued quarterly reporting of project costs and timelines to the Commission, Dublin Airport proposes using the format presented in the CIP2020+ Review document to report timelines. On this basis, three project phases will be reported, Pre-construction which will be feasibility/design/planning/procurement. A construction phase which will consist of the site works involved in the project. Finally, a handover section to signify when the project will be brought into operation. This will allow for a more straightforward reporting mechanism than currently in operation, but it will continue to deliver the essential information to the Commission and the wider public.

Trigger Projects Allowances

8.3.9 In its Draft Decision, the Commission has proposed a trigger mechanism allowing for 80% project remuneration at the start of construction and the remaining 20% when the project comes into operation. Dublin Airport understands the drivers behind these triggers due to the uncertainties associated with the project planning and approval processes. However, we would propose that it would be in the best interest of airport users if Dublin Airport could have a proportion of the value of these projects remunerated in advance of construction starting. This would fund the significant and detailed work required to prepare planning and design information and manage the planning process through to a successful conclusion before starting construction. This would also allow the recovery profile to match the spending profile and help to reduce overall financing risk.

8.3.10 Dublin Airport proposes that 20% should be funded, with the Type A trigger being changed to 60% and the Type B trigger remaining at 20%. This would smooth the funding process for these significant projects for the airport and enable the projects to be delivered on schedule. It would also allow for the airport charges to reflect the expenditure made by

countries introducing an initial raft of measures to combat the effects of the pandemic and others introducing their measures at different times across the period.

Dublin Airport. The assurance of renumeration would also help the IA approval process as Dublin Airport would have the resources readily available to drive the process. The approval of planning for this tranche of projects will represent a marked increase in spending by the airport and will need to be managed through procurement and construction planning to optimise resources through to delivery. Limited initial funding of 20% will allow the airport to plan this efficiently rather than immediately chasing the Type A trigger on all projects.

8.3.11 On this basis, Dublin Airport requests that the Commission reconsiders its approach to trigger projects for 2023-2026.

Deliverable Project Underspend Treatment

8.3.12 In its Draft Decision, the Commission stated that if a deliverable project is underspent in the CIP period, the grouped allowance should be reduced by the corresponding amount. Dublin Airport would prefer to redeploy any underspend in Deliverable projects in other projects within the same grouping and within the regulatory period. This would only occur where the scope of the deliverable project has been delivered for less than the agreed allowance. Therefore, the underspend has been generated through Dublin Airport efficiency and should be allowed to be redeployed in similar essential projects to maintain the airport. Dublin Airport would inform the Commission before redistributing this underspend to the proposed projects to ensure the efficient redeployment of this underspend. This would assure the Commission that the underspend is genuine and that the proposed transfer project is appropriate.

ME and CSF groupings sharing flexibility

8.3.13 As the ME and CSF asset management groupings are under the ultimate control of the asset management department, Dublin Airport is proposing that these groupings be merged to share flexible allowances. This will help redeploy allowances to areas of need to the asset management department across these two groupings. In its Draft Decision, the Commission outlined the need for flexibility in these groupings with the proposed treatment of the T1 façade project being changed to a flexible one. This would enhance the application of this flexibility across the whole asset management groups of projects.

Demonstration of Environmental Impact of Sustainability Projects

8.3.14 In response to the Commission's concern, we are proposing that the methods to demonstrate the environmental impact of projects will be outlined throughout the StageGate assessment process of these sustainability projects. Dublin Airport notes the acceptance of the return to a regular cycle and additional consultation with airport stakeholders through this regular consultation meeting.

Relocated South Apron Passenger Boarding Zone

8.3.15 Following the March 2022 CIP2020+ Review consultation process and follow-up engagement with a key South Apron Hub airline, Dublin Airport has been requested to integrate a replacement Passenger Boarding Zone (PBZ) adjacent to the relocated remote stands along the southern edge of the apron. A feasible high-level concept (subject to further design development and approvals) has been prepared since the CIP2020+ Review Consultation. It has been positively presented to the primary South Apron user airline.

8.3.16 An updated project sheet for the South Apron Expansion project sheet has been presented in Appendix 3 including the additional scope and cost for the inclusion of the Passenger Boarding Zone and associated works.

Alternative MRO facilities

8.3.17 Dublin Airport is committed to providing adequate MRO facilities at the airport. Dublin Airport will develop this as part of the North Apron project using the StageGate process to secure funding for the final project developed to facilitate MRO.

8.4 Conclusion

8.4.1 While Dublin Airport is broadly supportive of the Commission's approach to the roll forward of our current RAB, we are disappointed that a specific adjustment has not been included in the opening RAB for 2023 to allow for the recovery of a portion of revenues lost due to COVID-19. We also think this would be a more appropriate than accelerated depreciation as a means of addressing the financeability gap identified by the Commission.

8.4.2 As part of our 2022 Regulatory Proposition, Dublin Airport submitted a revised CIP2020+ where following consultation with our airport users, we set out our capital investment plans for 2023-2026.

8.4.3 We welcome the fact that the Commission is supportive of the revised CIP+2020 and that the Commission is proposing to provide an allowance for almost the projects set out in this investment programme.

8.4.4 We are disappointed to see the return of capital cost triggers in the price cap formula for 2023-2026 as this will potentially hamper development of greatly needed infrastructure at the airport going forward.

8.4.5 Dublin Airport is disappointed that the pro-rata treatment proposed in our 2022 Regulatory Proposition for capital investment has not been introduced by the Commission.

8.4.6 We are concerned that a mechanism to allow for construction inflation has not been permitted in this Draft Decision, given that this is a serious and significant factor that could threaten our overall CIP delivery.

8.4.7 We would hope that the Commission would look at address these issues in its forthcoming Final Decision.

Capital Investment Chapter Summary:

- Dublin Airport welcomes the fact that the Commission is supportive of the revised CIP2020+ and that the Commission is proposing to provide an allowance for almost all the projects set out in this investment programme.
- Dublin Airport is disappointed that the pro-rata treatment proposed in our 2022 Regulatory Proposition for capital investment has not been introduced by the Commission.
- We firmly believe that a specific adjustment should be made to the opening RAB for 2023 to allow for the recovery of a portion of revenues lost as a result of the pandemic.
- We are concerned that a mechanism to allow for construction inflation has not been permitted in this Draft Decision, given that this is a serious factor that could threaten our overall CIP delivery.

DublinAirport

Dublin Airport's response
CAR Draft Decision 2022

09

Financing & Financial Viability

9. Financeability

9.1 Introduction

9.1.1 The assessment of financeability is a key consideration in the Commission's approach to setting Dublin Airport charges. It is fundamental to ensure that the interests of passengers, airlines, and the wider Irish economy are protected by ensuring an efficiently run Dublin Airport is able to finance its functions, resiliently, over the course of the 2023-26 control period.

9.1.2 The Commission has a statutory objective to ensure the Financial Viability of its pricing decision. The objective is explicit in the existing statutory objectives and implicit in the revised objectives. Setting a financeable price decision remains equally important so that Dublin airport can operate and deliver the agreed upon capital investment by accessing the funding required.

9.1.3 Financeability encapsulates more than a simple metric test and needs to consider market appetite, timing, risk and expectations. In this context, Dublin Airport welcomes the involvement of Centrus.

9.1.4 In setting its draft decision, consistent with rating agencies guidance, the Commission has assessed whether the overall price settlement is financeable, with a particular focus on whether Dublin Airport meets threshold levels of two key credit metrics (FFO: net debt and net debt/EBITDA) as per S&P's methodology.

9.1.5 When the cash flow associated with the proposed decision does not meet the established credit rating metric, a sign that the price settlement provides insufficient funding over the duration of the price control, the regulator needs to reassess its decision. To effectively discharge its objectives, the assessment needs to enable the regulator to derive meaningful conclusions, therefore the financeability assessment has to follow best practice and rating agencies methodologies.

9.1.6 In this chapter, we respond to the Commission's proposals, where we disagree, we explain why and provide a solution.

9.1.7 This chapter is structured as follows:

- Section 1 sets out the context for this financeability assessment. The starting point and forward view are dramatically altered from 2019 **with almost twice as much debt in 2022 as 2019**, coupled with **higher interest rate costs, higher leverage,** a weaker industry than in 2019 and a volatile macro environment. It is not appropriate to apply the same

financial tests in 2022, post pandemic, as were applied in 2019. A more robust and careful approach is required as debt levels are now much higher and business risk is increased.

- Section 2 sets out Dublin Airport's response to the draft determination. While the Commission has correctly targeted BBB+, it is incorrect to deviate from the rating agencies methodology of setting a Net Debt / EBITDA threshold of 4.0x as per the "Intermediate" Financial Risk Profile score. In this section Dublin Airport also sets out the insufficiency of the Commission's sensitivity analysis and includes a multi-variable Monte Carlo risk assessment which shows that the current pricing decision does not meet the financeability requirements in the mean scenario, and that pricing in line with Dublin Airport's original proposition is required to ensure a financeable price determination. Lastly, Dublin Airport identifies a modelling error in the Commission's nominal interest cost.
- Section 3 sets out Dublin Airports response to the Commission's Financeability decision. The Commission's approach of accelerating depreciation is not the correct approach as it only borrows from the future and does not correct for longer term financial viability. Recent UK regulatory decisions have also found this to be an insufficient approach.
- Section 4 sets out Dublin Airports view as to best respond to the identified financeability issue. Rather than accelerating depreciation, allowing for a correct cost of capital corrects the financeability issue without damaging future regulatory period. Apply a robust sensitivity analysis is also required to ensure that the regulated entity remains financeable in most likely market conditions.

9.2 Context for this financeability assessment

9.2.1 The starting point and forward view are dramatically altered from 2019 with almost twice as much debt in 2022 as 2019, coupled with higher interest rate costs, higher leverage, a weaker industry than in 2019 and a volatile macro-economic environment. It is not appropriate to apply the same financial tests in 2022, post pandemic, as were applied in 2019. A more robust and careful approach is required as debt levels are now much higher and business risk is increased.

9.2.2 The Commission's overall pricing decision, and in particular its financial viability review, does not reflect the impact of the COVID-19 crisis on Dublin Airport's current financial position (i.e. net debt and leverage), higher interest rate environment and the increased burden that construction inflation and sustainability requirements will have over the upcoming regulatory period. The table below compares the Dublin Airport's financial position in 2019 and 2022.

- **TABLE 9.1 DUBLIN AIRPORT FINANCIAL POSITION 2019 VS 2022**

	2019 position	2022 position	Change
Net debt	€575m	[redacted]	1.7x
FFO: Net Debt	42.5%	[redacted]	-63%
Net debt/EBITDA	2.1x	[redacted]	+3.8x
10-year Mid Swap	20bps	175bps	+155bps
daa Credit Swap	80bps to 100bps	130bps to 150bps	+50bps
CIP cost	€2.1bn	€3.0bn	41%
Passenger levels	32.9m	[redacted]	-24% to -20%
BOI Economic Pulse (June)	90.7	78.8	-13%
BOI Consumer Pulse (June)	90.6	51.3	-43%

(Source: Dublin Airport)

9.2.3 The starting position for net debt has increased by [redacted] times, increasing from €575m at end 2019 to [redacted] at the end of 2022. [redacted] is already back at historically high net debt levels, last seen at the end of the previous large investment plan. Leverage has also changed massively, now [redacted] compared to 2.1x in 2019. The previous peak net debt was c. [redacted] in 2011, following the completion of a €1.2bn capital investment plan and in the depths of the post 2009 financial crash. At this time Net Debt/ EBITDA peaked at 5x.

9.2.4 The net debt of c.[redacted] is now the starting point for the €3bn investment plan which will see net debt grow by a further [redacted] by 2026. At this point a further €0.9bn of the current CIP will remain outstanding and likely require funding in the next regulatory period (if not before) in addition to our 2028 €550m bond which will require refinancing in 2027 at the latest.

- **FIGURE 9.1 DUBLIN AIRPORT NET DEBT 2009 - 2022**

(Source: Dublin Airport)

9.2.5 This has driven credit metrics to be out of tolerance levels for the "Intermediate" FRP category that is required for the target standalone credit profile ("SACP") of BBB+ with Net Debt: EBITDA forecast to be at [redacted] in December 2022.

9.2.6 This increase in net debt since 2019 and the prospective increase in net debt out to 2026 needs to be funded though new gross debt (i.e. the additional €1.2bn will be via new external funding). The graph in figure 9.2 below shows how the level of new debt required between 2020 and 2026 will increase by [redacted] compared to the 2019 decision.

9.2.7 Dublin Airport will need to access the credit market consistently over the coming 5 years, and again out to 2031. This has not been attempted by Dublin Airport previously. The graph below shows daa's history in the debt markets. A total of €1.8bn was raised in drawn debt in the 16 years between 2001 and 2016 and is now expected to raise [redacted] over the 8 years between 2020 and 2027.

- **FIGURE 9.2 DUBLIN AIRPORT NEW DEBT REQUIREMENTS 2020 - 2027**

- **FIGURE 9.3 DUBLIN AIRPORT NEW DEBT 2001-2027**

(Source: Dublin Airport)

9.2.8 The Commission may take some reassurance from Dublin Airport's ability to survive the post 2010 period, however this is unrealistic. Setting aside the much more severe and prolonged impact that COVID-19 has had in the airport relative to the financial crisis, the airport was in diametrically opposed situations in 2010 and to where it is now. No new debt was required between 2009 and 2016. This will not be the case now, as the current investment plan and existing debt will need to be refinanced in 2027 and 2031 at the very latest.

9.2.9 Accompanying this increase in debt is an increase in interest costs. Dublin Airport's embedded cost of debt is c.1.5%, however in July 2022 daa's listed debt was trading at a market implied interest rate of ~3.5%. Applying this rate to [redacted] of new debt will increase Dublin Airport interest cost annually by [redacted] by 2026, increasing by a further [redacted] in 2027 when the €550m 2028 Eurobond is refinanced.

9.2.10 Figure 9.4 below shows how the midswaps and credit spread have changed from 2019.

- The 10-year mid swap has increased from c20bps in June 2019 to c175bps in 2022
- daa's credit spread has increased from [redacted]
- Overall >200bps increase in borrowing costs, at a total cost of c. 3.5%

FIGURE 9.4 EUROBOND MIDSWAPS AND DAA CREDIT SPREAD 2019 VS 2022

(Source: Barclays)

9.2.11 In addition to higher interest rates, the investment grade ("IG") market has remained volatile with periods where the market has been closed even to the strongest borrowers and this volatility is expected to remain as investors have to digest wider macro-economic picture. This means that there is no certainty of access to the market which has, on the whole, been there for last numbers of years (and definitely at the last regulatory period). See below from HSBC which shows the year-to-date volume of IG borrowing, compared to 2021 and 2022.

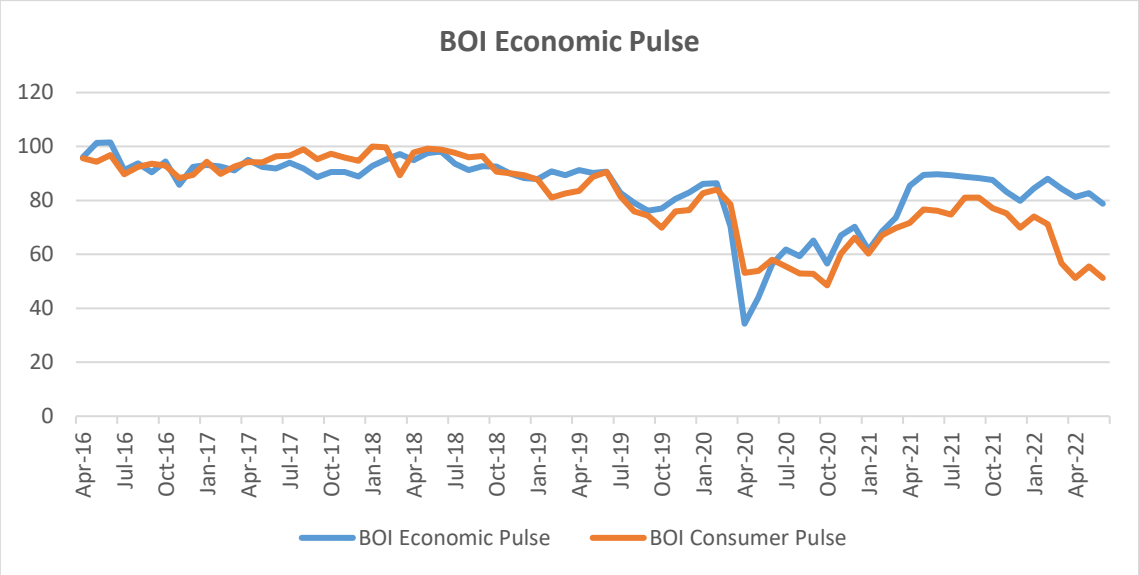
- **FIGURE 9.5 TOTAL SUPPLY OF SENIOR INVESTMENT GRADE CREDIT**

Total Senior IG Supply*			EUR
	2022 FY	2021 FY	2020 FY
January	32,600 (+4%)	31,350	25,325
February	12,900 (-51%)	26,175	30,950
March	41,750 (-4%)	43,275	49,100
April	7,800 (-61%)	19,750	65,325
May	34,000 (+12%)	30,350	62,275
June	15,750 (-56%)	36,100	52,180
July	2,500 (-74%)	9,540	22,360
August	2,750 (-81%)	14,410	650
September	-	39,000	45,200
October	-	25,274	20,450
November	-	28,799	22,300
December	-	3,750	8,600
Grand Total	**150,050**	**307,773**	**404,715**
YTD	**150,050 (-26%)**	**201,740**	**307,515**

9.2.12 Dublin Airport will now start off the next regulatory period with passengers c. 20% lower than they were in 2019, against a backdrop of much weaker economic and consumer confidence than in 2019. The graph below shows the data for Bank of Ireland's Economic Pulse Index[44] between April 2016 and June 2022. This shows an average overall economic pulse of 84.9 in 2019 which has fallen by -7% to 78.8 in June 2022. More critically for Dublin Airport, this shows that the consumer pulse has fallen -36% from an average of 80.7 in 2019 to 51.3 in June 2022. This June 2022 index is lower than any point during COVID-19.

[44] Bank of Ireland Economic Pulse

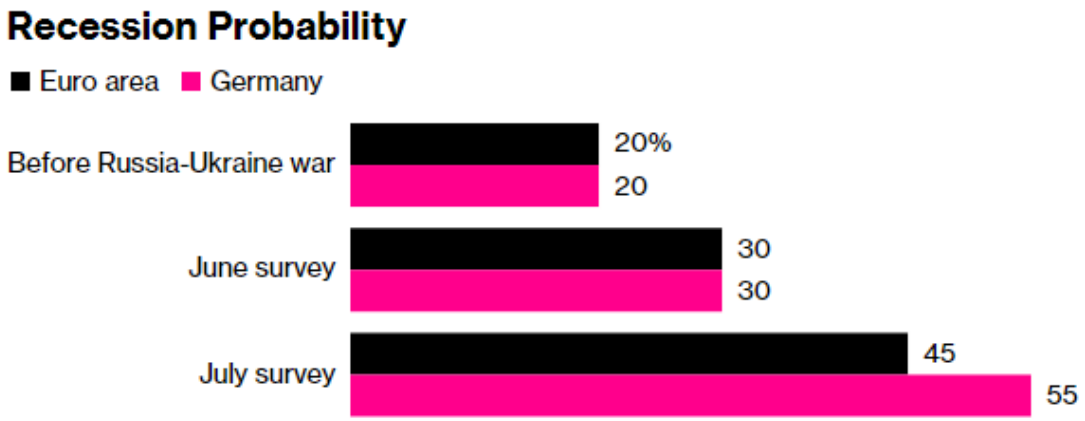
- **FIGURE 9.6 BANK OF IRELAND ECONOMIC PULSE APRIL 2016 - JUNE 2022**



(Source: Bank of Ireland)

9.2.13 Bloomberg's July 2022 survey also signals a riskier economic time ahead with 55% of respondents predicting a Eurozone recession probability in the next 12 months. This is up from 45% in June and 20% before the Russia-Ukraine war.

- **FIGURE 9.7 BLOOMBERG EUROZONE RECESSION PROBABILITY JULY 2022**



Source: Bloomberg survey conducted July 1-7
Note: Responds asked about probability of a recession in the next 12 months

9.2.14 This combination of increased starting debt levels, increased borrowing costs and weakened economic indicators need to be taken into consideration when testing the final pricing decision for financial viability. This Determination must ensure that access to debt markets

remains open to Dublin Airport by targeting a BBB+ credit rating with the correct ratios and thresholds as per rating agencies guidance and by running sensitivity analysis which takes into account the current market trends and sentiments.

9.3 Dublin Airport's response to the Commission's financeability assessment

9.3.1 The Commission does not achieve its own targeted financeability metrics in its base case. The Commission's approach of applying their credit metric test to a "downside scenario" is incorrect as credit rating agencies apply these tests to base case scenarios.

9.3.2 Dublin Airport recommends targeting a <4.0x Net Debt / EBITDA metric as it:

a) Aligns with S&P's methodology,
b) Protects the overall financeability of Dublin Airport against the coming increase in interest rates and
c) Aligns with peer airport targets.

9.3.3 The Commission's sensitivity analysis is insufficient. Dublin Airport has carried out a multi-variable Mote Carlo risk assessment which shows that the current pricing decision does not meet the financeability requirements in the mean scenario, and that pricing in line with Dublin Airport's original proposition is required to ensure a financeable price determination.

9.3.4 The Commission has both used an out-of-date nominal interest rate and applied an incorrect calculation for nominal interest within its financial model. This understates the cost of borrowing in 2026 by €45m and worsens the base case credit metrics further to FFO:Net Debt of 14.4% in and Net Debt/EBITDA of 5.4x.

The Commission correctly targets a BBB+ credit rating

9.3.5 The Commission correctly targets a BBB+ credit rating which reflects Dublin Airport's operational environment and is consistent with the 2019 decision. BBB+ provides appropriate headroom against to meet associated key rating thresholds to secure financial resilience (best practice dictates this is derived via downside sensitivity analysis of cost shocks) threshold.

The Commission deviates from credit rating guidance to set a BBB+ rating

9.3.6 The methodology used by the Commission to ensure financial viability is incorrect. The Commission presents base case financial metrics, including a financeability adjustment, which fails to achieve the financial metrics that it sets out to achieve. The table below shows the metrics which exceed the Commission's target threshold for <5.0x Net Debt/EBITDA in 3 of the 4 years. The appropriateness of using <5.0x as the correct threshold for net debt/EBITDA is discussed later.

- **FIGURE 9.8 BASE CASE CREDIT METRICS IN DRAFT DECISION**

(Source: CAR, Dublin Airport)

9.3.7 The Commission only appears to apply the target metrics to a "downside scenario" in which no dividends are paid. Dublin Airport does not understand why the credit metric test is applied to a "downside scenario." Credit rating agencies apply these tests to base case scenarios, particularly when metrics are moved to the extremity of the metric threshold.

Targeting 4.0x is the most appropriate Net Debt / EBTIDA threshold

9.3.8 S&P sets out a simple methodology for calculating FRP. The two key metrics are FFO: Net Debt and Net Debt / EBTIDA. For an entity with a low "Strong" Business Risk Profile, such as Dublin Airport, FFO: Net Debt must be maintained between 13% and 23% and Net Debt / EBITDA between 3x and 4x.

FIGURE 9 – S&P FINANCIAL RISK PROFILE METHODOLOGY

	FFO: Net Debt	Net Debt / EBITDA	Credit Rating
Minimal	>35%	<2x	AA/AA-
Modest	23% - 35%	2x - 3x	A+/A
Intermediate	13% - 23%	3x - 4x	A-/**BBB+**
Significant	9% - 13%	4x - 5x	BBB
Aggressive	6% - 9%	5x - 6x	BB+
Highly Leveraged	<6%	>6x	BB

9.3.9 The Commission has taken on board Centrus' recommendation to target a net debt / EBITDA ratio of <5.0x and applied this to a "downside scenario".

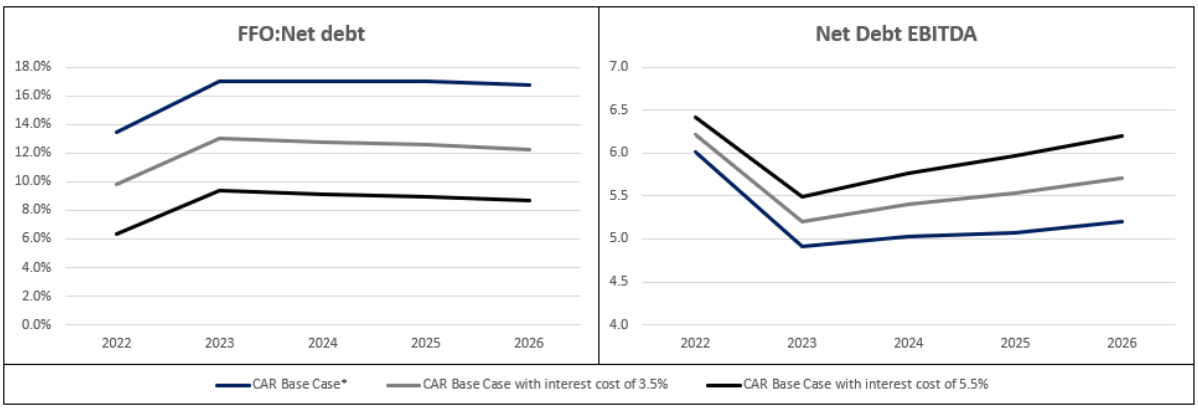
9.3.10 Dublin Airport is recommending that the Commission apply a 4.0x threshold to the base case financial model and also apply it to robust sensitivity analysis. 4.0x is a more appropriate threshold for two reasons:

- It is the threshold for an "Intermediate" FRP per the S&P methodology, and therefore links directly to a BBB+ SACP, therefore ensuring Dublin Airport remains at "Intermediate".
- Increasing interest costs will have a larger impact on FFO: Net debt than net debt / EBITDA as interest is included in FFO. As interest rates normalise, these two metrics will align in terms of S&P's FRP rating as FFO falls but EBITDA is unchanged. As such, both metrics are of equal importance and need to start at the intermediate level since relaying on FFO/Net Debt in isolation would expose Dublin Airport given the sensitiveness of this ratios to changes in interest rates.
- A Net Debt / EBITDA metric of 4.0x aligns with peer airports' metrics and stated targets.

9.3.11 Interest rates have been historically low for the past decade; however, this is changing. ECB have already increased base rates by 0.50% while in the US, the FED has increased rates by 2.25% and the UK Central Bank rate has been increased by 1.5%. This trend is anticipated to continue and must be incorporated into the financial viability testing.

9.3.12 The graph and subsequent table below illustrate the impact increased rates can have in the medium term. The Commission's base case results in FFO: Net debt with an "Intermediate" FRP and a Net Debt / EBITDA which is "Aggressive". The table below shows how an increase in interest costs of c.2% to 3.5%, applied to all debt for the four years would move the FFO: Net Debt to "Significant" while Net Debt /EBITDA would remain at "Aggressive". A further increase in interest costs to 5.5% would result in FFO: Net Debt FRP of "Aggressive" and Net Debt /EBITDA FRP of "Highly Leveraged".

FIGURE 9.9 IMPACT OF INTEREST RATE CHANGES OF CREDIT METRICS



**CAR Base Case includes modelling error referred to below*

9.3.13 From this analysis it is clear to see how volatile FFO: Net Debt is to interest rate changes. daa's 2018 Bond, raised in 2008, carried an interest cost of 6.6%, rates in excess of 5% are not implausible. A thorough financeability review must consider the likelihood of this, and the impact of compounding years of increase interest rates, when setting target credit metric thresholds.

9.3.14 Therefore, both ratios are of equal importance and need to be calibrated at an intermediate FRP in the base case, since investors would consider the financeability assessment in the round. For example, relying on a single ratio that is subject to significant volatility could undermine Dublin Airport's investability in the event that interest rates continue to raise, in particular when the Net Debt/EBITDA ratio is set at an aggressive level in the base case.

FIGURE 9.10 IMPACT OF INTEREST RATE CHANGES ON S&P FINANCIAL RISK PROFILE METHODOLOGY

	CAR Base Case*		CAR Base Case with interest cost of 3.5%		CAR Base Case with interest cost of 5.5%	
	2026	S&P FRP	2026	S&P FRP	2026	S&P FRP
FFO/ net debt	16.8%	Intermediate	12.2%	Significant	8.7%	Aggressive
Net Debt/ EBITDA	5.20	Aggressive	5.71	Aggressive	6.20	Highly Leveraged

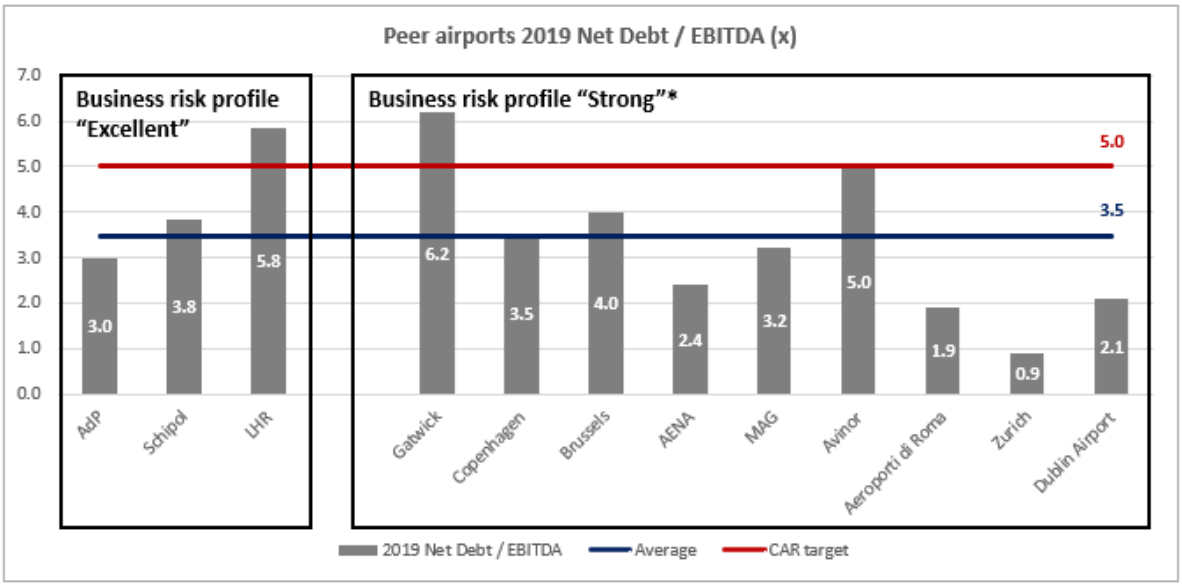
9.3.15 Peer European airports target Net Debt / EBITDA lower than 4.0x. The graph below shows 2019 Net Debt / EBITDA for peer European airports. This shows an average metric of 3.5x, lower than Dublin Airport's ask of a target of 4.0x.

9.3.16 While some peers do have higher metrics, these have a demonstrably different funding approach and ownership structure (and therefore access to equity) compared to Dublin Airport, which cannot be copied due to Dublin Airport's existing debt structure and ownership.

- Gatwick Airport takes an aggressive approach to funding and has a securitised structured which gives significant lender controls and protections over the main business.
- Brussels Airport borrows on a secured and covenanted basis. Higher leverage is a result of shareholder distributions. Moody's note that it has a "shareholder-friendly financial policy… to distribute 100% of its annual free cash flows." Brussels Airport's 2019 USPP debt of €500 million was secured.
- Copenhagen (majority privately owned) has a long-standing policy to distribute 100% of net profit after tax. At Copenhagen, debt is held both at holding company and operating company levels with covenants at the holding company level based on consolidated

ratios. The secured financing structure includes some elements of senior creditor protection such as six-month debt service liquidity and a covenant package that incorporates financial covenants.

FIGURE 9.11 PEER AIRPORT 2019 NET DEBIT / EBITDA METRIC



(Source: CAR, Dublin Airport)

**S&P BRP of "Strong" / Fitch "Stronger"*

CASE STUDY – Manchester Airport Group's pre-COVID approach to its transformation programme

Manchester Airport Group ("MAG") is the owner of Manchester and Stansted airports. In 2019, MAG had embarked on a £1bn transformation programme at Manchester Airport While simultaneously planning to increase the capacity at Stansted from 35mppa to 43mppa with a £0.6bn investment plan.

Pre COVID, MAG held a BBB+ rating (Baa1 with Moody's & BBB+ with Fitch) with leverage of 3.1x. Even with a BBB+ credit rating, MAG's debt is secured and includes covenants:

- Lock-up covenant at 6.0x leverage and 2.0x interest cover, and
- Default covenant at 7.5x leverage and 1.5x interest cover.

MAG publicly committed that "leverage will increase through the investment cycle but will be sized to maintain strong adjusted rating metrics aligned with current Baa1/BBB+ ratings[45]". In its November 2018 ratings update, Moody's outline that "management targets a long-term Net Debt/EBITDA level of around 4.0x times." This outlines how a peer airport considers 4.0x to be the peak metric to target, even with an ambitious capital plan.

Moody's credit rating report also explains how MAG, at BBB+, has had to enter "into a ring-fenced senior secured debt structure which provides for the raising of bank debt and bonds on a pari passu

[45] https://www.magairports.com/media/1571/mag-investor-presentation-fy19-interim-final.pdf pg 25

basis. The structure includes a comprehensive security package and formal intercreditor arrangements."

The Commission's sensitivity analysis is insufficient

9.3.17 A robust sensitivity analysis is fundamental to performing a conclusive financeability test. The sensitivity analysis is the only way that the regulator can confirm that the entity is fundable through the regulatory period, in most possible scenarios.

9.3.18 The sensitivity analysis carried out by the Commission in the Draft Decision is too simplistic and does not adequately address the risks that it identifies. A financeability assessment should not be applied solely to one financial model variable at a time. In particular, it should not be applied to the regulator's hypothetical version of the regulated entity.

9.3.19 The Commission does not provide clear details of the sensitivity analysis it has carried out. One table is provided (Table 12.7) which gives the results of a 10% reduction in passengers and shows net debt at almost 6.0x EBITDA. There is no assessment described as to the likelihood of this scenario and the fact that it would push Dublin Airport.

9.3.20 Regulatory best practice provides that regulators perform sensitivity analysis on the risk of potential underperformance of key building blocks that drive the ratios. In Dublin Airport's case, these include opex, commercial revenues and more importantly passenger numbers. UK CMA experience:

"We recognise that the actual credit ratings will be influenced heavily by the ability of the water companies to achieve the cost and outcomes targets set for AMP7. It is therefore important to consider whether the assumptions made about costs and outcomes are likely to be achievable in practice, and whether the balance of risk for the companies is consistent with those credit ratings. We have also modelled downside scenarios to assess financial resilience to a reasonable downside in operational performance."

9.3.21 Dublin Airport's view is that to ensure and financeable pricing decision, a robust, multi-variable sensitivity analysis should be carried out.

9.3.22 Dublin Airport has carried out a Monte Carlo simulation of key risks to Dublin Airport's financial forecasts.

9.3.23 For the Monte Carlo simulation, the top nine risks within the business were identified with a low, high and base outcome and distribution range between these. The model then runs 1,000 random outcomes within these parameters and generates the range of likely outcomes and confidence levels. The risks areas identified for the exercise were:

- CPI
- Passenger growth/decline

- Core opex levels (excluding CPI and passenger impact)
- Core commercial revenue levels (excluding CPI and passenger impact)
- Capital investment requirement (excluding CPI)
- Interest costs

9.3.24 This review shows that the Draft Decision fails to meet the required credit metric thresholds in both the mean and 80% confidence levels. The graph below shows how a mean FFO: Net debt is only [redacted] for 2025 and 2026, and Net Debt / EBITDA of [redacted] for the entire regulatory period.

FIGURE 9.12 SENSITIVITY ANALYSIS RESULTS

[redacted]

9.3.25 The 80% confidence low sensitivity shows a likelihood of FFO: Net debt falling to [redacted] and Net Debt / EBITDA reaching close to [redacted].

9.3.26 The sensitivity analysis demonstrates the requirement for airport charges in line with Dublin Airport's proposition. A price increase of [redacted] per annum returns Net Debt / EBITDA to c.4.0x and FFO: Net Debt to c.20%. A [redacted] increase in pricing also brings the 80% confidence interval to c.5.0x and FFO: Net Debt at 15%.

TABLE 9.2 IMPACT OF [redacted] INCREASE IN PRICING

[redacted]

Modelling errors: Nominal interest rate and calculation used by the Commission

9.3.27 Dublin Airport notes two issues with the Commission's nominal interest cost calculation within the financeability test carried out.

- There appears to be a calculation error in the interest cost for new debt.
- The interest rate for new debt is lower than the current market cost of new debt.

9.3.28 The calculation of nominal interest in financial the Commission model appears to apply a new borrowing cost of 1.87% to only the new debt required in the current year, rather than the cumulative new debt.

- Focusing on 2026, the total nominal interest cost is €27.1m. The formulas come to this value by taking the embedded debt of €1,418m at 1.49% (€21.1m) plus the new debt in the year of €321.4m at 1.87% (€6.0m)
- However, the nominal gross debt in 2026 is shown as €2,741m, meaning that there is €1,323m of new debt with a nominal interest cost of €26.9m. This gives a total interest cost of €48m, €21m higher than is in the financial model.
- This worsens the based case credit metrics further to FFO:Net Debt of 15.7% in and Net Debt/EBITDA of 5.3x in 2026.

9.3.29 As discussed earlier and shown below, the current market borrowing cost on new debt is c3.5%. Also shown in the table below is the make-up of daa's historic coupons, illustrating how pre-2009 rates of >6% were normal and could easily return. A thorough sensitivity analysis should review the impact of interest costs at these historic levels. The Commission / Swiss Economics appear to have used 31 December 2021 data points which should be updated.

TABLE 9.3 DUBLIN AIRPORT CURRENT AND HISTORIC PRICE OF NEW DEBT

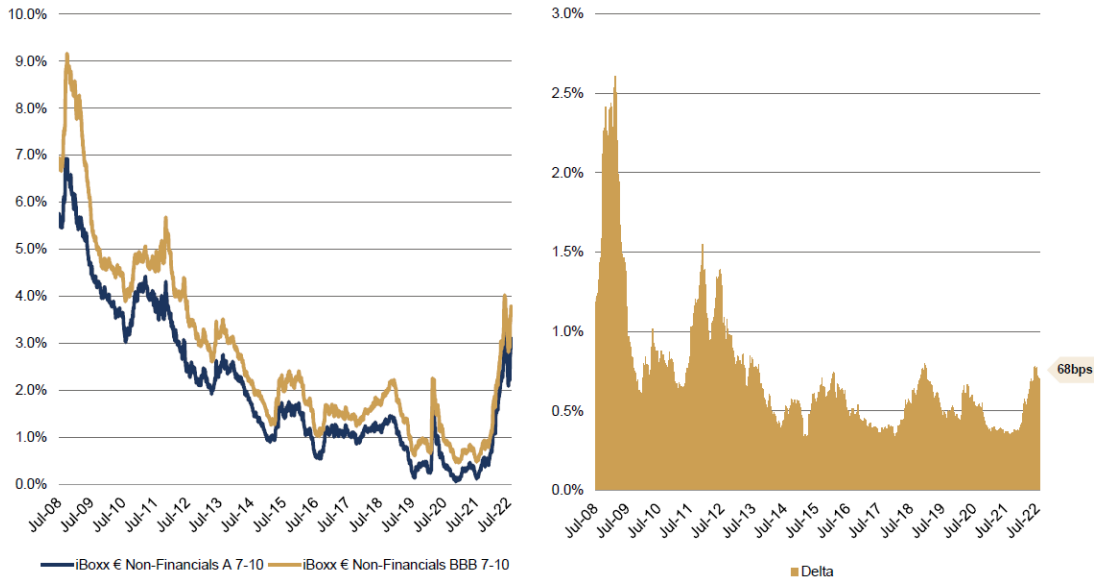
	Current		2001	2008	2016	2020	2021
	Price Range		10 year	10 year	12 year	12 year	Tap of 2016
Midswap rate	1.75%	1.75%	5.28%	5.0872%	0.7040%	-0.199%	-0.177%
daa credit spread	1.30%	1.50%	0.87%	1.50%	0.85%	1.80%	0.68%
New issue premium	0.20%	0.40%					
Coupon	**3.25%**	**3.65%**	**6.15%**	**6.5872%**	**1.554%**	**1.601%**	**0.503%**

9.3.30 Correctly applying a 3.5% cost of new debt to the Commission's model increases the 2026 nominal interest cost to €73m, some €45.5m higher than the Commission's current calculation. This worsens the base case credit metrics further to FFO:Net Debt of 14.4% in and Net Debt/EBITDA of 5.4x in 2026.

9.3.31 This cost of debt of 3.5% is based on Dublin Airport's current A- credit rating. As the Commission is moving Dublin Airport to a BBB+ rating, this cost of debt would increase by a

further 20bps. The graph below shows A category vs BBB category at a differential of 68bps i.e. 20bps would generally be seen as A- vs BBB+.

- **FIGURE 9.13 BOXX € NON-FINANCIAL 7-10 BOND INDICES**



9.4 Dublin Airport's response to the Commission's proposed financeability adjustment

9.4.1 The recurring requirement for a financeability adjustment suggests a problem with the other building block inputs. This decision makes the fourth straight Commission decision that has required a financeability adjustment. Continual financeability issues suggests that that the WACC or RAB used by the Commission is understated and is contributing to the need for adjustments.

9.4.2 Accelerated depreciation is not the appropriate mechanism for a financeability adjustment, it borrows from the future and as such is often discounted by borrowers and rating agencies.

9.4.3 Rather than accelerating depreciation, allowing for a correct cost of capital, with an appropriate asset beta, corrects the financeability issue without damaging future regulatory period.

9.4.4 The Commission correctly identifies a financeability problem with its decision. To address it and following ill-advised recommendations from Centrus it discusses potential options to address it:

- Reduce investment. But it correctly concludes that it would not be in the best interest of consumers since it concludes that Capital Investment is in the interest of consumers.
- Increase the pre-funding rate of triggered projects. It decides to increase the rate at which triggered projects enter the RAB (from 50% to 80%) so that they generate greater initial cash flows to aid financeability.
- Accelerate depreciation so that revenue for future price controls is used to achieve a financeable outcome in the 2023-2026 period. It decides to perform a 60m Euro adjustment.

9.4.5 Dublin Airport strongly opposes the depreciation adjustment. Accelerated depreciation brings future revenues forward to correct current financeability issues. This approach has a number of problems:

- It is poor regulatory practice. If the financeability test is not met - it is indicative that the decision is not appropriately calibrated - risks/rewards are not balanced. The solution is to reconsider the very core of the decision rather than making ad-hoc adjustments to it. As set out, in the following section, this calls for a WACC adjustment.
- The depreciation adjustment does not increase financeability overall because it does not provide increased cash flows to Dublin Airport over time.
- Furthermore, it does not affect the perception that the airport is more financeable since rating agencies and therefore lenders would discount it in their assessment.
- It is not consistent with best practice as demonstrated by CMA precedent in the 2021 Water Appeals.
- Creates a chronic problem as demonstrated by the 4th adjustment in a row and creates a financeability risk in the future.
- Undermines the “users pay principles” and generates the need for a further adjustment in the future. By the end of 2026, over €220m (Feb 2022 prices) will have been brought forward from future periods and used as financeability adjustments over the period since 2010. This RAB reduction will weaken financeability of future periods.
- Undermines the current unitisation approach to depreciation where depreciation has been calculated using “annuities” in order to make the capital costs (return on capital + depreciation) in each year of the asset life constant if the cost of capital remains the same. The use of annuities implies that, with the overall “capital costs” fixed, and with a larger return on capital component at the beginning of the asset life (as the RAB is larger), depreciation is increasing throughout the lifetime of the asset. However, it seems inconsistent that the Commission uses accelerated depreciation to address financeability issues while at the same time using an approach that artificially shifts depreciation into the future.

9.4.6 NPV-neutral revenue advancements from future periods are unlikely to address a financeability issue and will instead ‘store up’ problems for the future. Some credit rating agencies now ‘look through’ regulatory adjustments that are NPV-neutral (such as modifying

the capitalisation rate or the depreciation profile) when assessing creditworthiness.[46] The UK Competition and Markets Authority (CMA) considered financeability levers at length in the recent PR19 redeterminations for four appellant water companies. The CMA concluded that: 'we do not agree with Ofwat's approach of advancing future cash flows to AMP7 to address financeability concerns. We doubt the extent to which accelerating cash flows from future periods can improve the credit quality of a regulated business, as there is no change in the revenues available to meet financing obligations over time…If an NPV-neutral [advancement] does improve credit quality in AMP7 then there must be an opposite effect of reducing credit quality in future periods, and therefore future customers may also face the same uplift to bills while companies are more likely to be downgraded by the rating agencies.'[47] The fact that this is the fourth consecutive period in which some form of revenue advancement has been needed highlights that attempting to tackle a revenue shortfall through NPV-neutral adjustments merely pushes the problem onto future regulatory reviews. The Commission has now got itself into a vicious cycle of advancing revenue from the future to make ends meet today.

9.4.7 Consequently, where the financeability assessment highlights an issue around credit quality, the regulator should consider NPV-positive financeability adjustments. The CMA has advocated for using financeability as a cross-check of the sufficiency of the allowed return on capital. It states that: 'the WACC should be the primary factor in the redetermination in determining whether an efficient firm which meets its cost and outcome targets can finance its functions. As a matter of principle, if the WACC is set at a reasonable level, both debt and equity investors should earn sufficient returns to cover the costs of financing. We also recognise that credit ratio analysis plays a supporting role: it provides cross-checks to help consider whether the allowed return is in practice high enough to be consistent with the investment-grade credit quality (as required by the licence with respect to debt financing).' A failure to meet target credit ratios is an indication that the allowed rate of return has been set too low. The fact that the price settlement does not meet the minimum credit thresholds even after allowing for a 50bp 'aiming up' allowance is clear indication that the pre-aiming up cost of equity allowance is an under-estimate of the actual requirement.

[46] For example, Moody's and Fitch excluded Ofwat's adjustments to depreciation profiles and pay-as-you-go rates in PR19 from their calculation of key credit metrics. Moody's stated that: '*The regulator views the adjustment of PAYG and run-off rates as economically equivalent to the change in indexation measures, because they involve a trade-off between fast money (received through revenue through the detriment of RCV growth) and slow money (increased RCV growth with lower short-term revenue). However, we believe that there is a key difference: the switch to CPIH is a permanent change that applies to all companies in a similar way, while PAYG and run-off rates are partly within companies' control and can change between periods, distorting comparability between companies and over time. We will continue to remove the regulatory depreciation as well as excess PAYG to calculate company-specific AICR ratios.'* Moody's (2019) , 'Ofwat tightens the screws further', July.

[47] Competition and Markets Authority (2021), 'Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited price determinations ', Final Report, 17 March, pp. 1119-20.

9.5 Dublin Airport's proposed solution to set a financeable 2023-2026 determination

9.5.1 For the reasons illustrated above, an adjustment of regulatory depreciation does not improve the financeability of the determination.

9.5.2 To set a financeable Final Decision, the Commission needs to identify an appropriate solution. The Commission could consider making adjustment to the operational building blocks (opex, commercial and pax) but this would be incorrect, since the operational building blocks do not have an impact on the overall financeability of the decision (i.e. insofar as they are appropriately calibrated, Dublin Airport would be able to achieve them generating the same cash flow as in the determination). Furthermore, operational building blocks are set at an efficient level, therefore providing less challenging targets to set a financeable outcome would have no economic basis and would lack precedent.

9.5.3 The Commission could consider adjusting the capex plan down. This again would be poor regulatory practice since the Commission recognises that the proposed capital investment plan is in the interest of consumers.

9.5.4 The Commission may consider changing the remuneration profile to a full pre-funding. This would raise concerns from the airlines and consumers.

9.5.5 The Commission may consider an adjustment to the opening RAB for 2023 as proposed in Chapter 8, this could be used to address any financeability shortfall.

9.5.6 However, on balance, the optimal solution to ensure a financeable outcome that meets a BBB+ (i.e. correctly calibrated decision) that appropriately rewards Dublin Airports for the risks in 2023-26 period is to reassess the WACC.

9.5.7 Risk is set through the asset beta. The Commission's estimate is wrong and the proposed asset beta does not compensate Dublin Airport for increased risk following COVID (0.56 vs Dublin Airport's proposed asset beta based on market data).

9.5.8 The Commission's proposed asset beta implies that Dublin Airport is less risky than Heathrow, (Heathrow asset beta pre-volume risk sharing adjustment is 0.62 vs 0.56). This is obviously flawed given:

- S&P's "Business Risk Profile" shows Heathrow as one notch higher (Excellent) than Dublin (Strong)
- Heathrow's hub status
- Diversified nature of Heathrow's carriers
- Excess of demand and capacity constraints

- Attractiveness of London

9.5.9 As it is set out in the WACC chapter, the asset beta should be set at an appropriate level, in which case a depreciation adjustment would not be required.

9.5.10 Testing the result with a robust set of sensitivity analysis is also required to ensure that the regulated entity remains financeable in most likely market conditions.

9.6 Conclusion

9.6.1 The Commission has correctly identified a financeability constraint within the draft pricing decision. The Commission correctly targets a BBB+ credit rating to assess the financeability of the Draft Decision. It should continue to target a BBB+ in the Final Decision.

9.6.2 However, the Commission's conclusion that the financials generated by the building block outcome (before a depreciation adjustment) are consistent with a BBB+ rating is inaccurate.

- Net Debt/EBITDA ratio averages 5x over the price control, this is consistently and significantly off the required ratio of 3-4% as set out by S&P's guidance.
- Investors' appetite for Dublin Airport's debt placement will be affected by the size of the investment plan, the recovery nature of the price control with an increased volume risk and the current economic environment (inflation and increases in interest rates). Given the increased risks, it is more important than ever that both ratios are met for a BBB+ rating.
- The Commission's final proposals should enable Dublin Airport to achieve both credit rating ratios consistent with BBB+ ratios by setting an appropriate WACC.

9.6.3 The sensitivity analysis performed by the Commission is incomplete. This leads to setting a price control determination that does not provide the right buffer to meet key financing ratios and an inaccurate assertion that the Draft Decision is financeable at a BBB+ rating. Dublin Airport's robust sensitivity analysis shows that the current pricing decision does not meet the financeability requirements in the mean scenario, and that pricing in line with Dublin Airport's original proposition is required to ensure a financeable price determination.

9.6.4 The depreciation adjustment does not enhance financeability and is inconsistent with regulatory best practice. Implementing it would undermine users' interest.

9.6.5 To ensure a fully financeable final decision the Commission needs to correct errors in its approach to assessing the financeability of the Final Decision and set the asset beta at an appropriate level in the range of 0.61 - 0.72 as set out by NERA under approach 2.

9.6.6 In closing it should also be noted that the CMA in its PR19 redeterminations[48] states that it does not agree with Ofwat's approach of advancing future cash flows to address financeability concerns. The UK High Court further held in its decision in R (on the application of Albion Water Limited) v Water Services Regulation Authority that a decision-making body must give weight to and cannot ignore a consideration to which it is required to have regard. We submit that Dublin Airport's submissions of the proposals, including those set out above have not been given due consideration by the Commission to date. In addition, we reassert the above submission that a very high evidential standard must be met in order for the Commission to favour its own projections – which are not closely linked to actual historic data – over Dublin Airport's.

Financeability Chapter Summary:

- The Commission has correctly identified a financeability constraint within the 2022 draft pricing decision. The Commission correctly targets a BBB+ credit rating to assess the financeability of the Draft Decision.
- In terms of financial ratios, Dublin Airport recommends targeting a <4.0x Net Debt / EBITDA metric as it aligns with S&P's methodology, protects the overall financeability of Dublin Airport against the coming increase in interest rates and aligns with peer airport targets.
- The financeability sensitivity analysis performed by the Commission is incomplete. This has resulted in a price control determination that does not provide the right buffer to meet key financing ratios and an inaccurate assertion that the Draft Decision is financeable at a BBB+ rating.
- Dublin Airport's robust sensitivity analysis shows that the current pricing decision does not meet the financeability requirements in the mean scenario, and that pricing in line with Dublin Airport's original proposition is required to ensure a financeable price determination.
- The Commission is proposing using accelerated depreciation to ensure financial viability. Accelerated depreciation is not the appropriate mechanism for a financeability adjustment, it borrows from the future and as such is often discounted by borrowers and rating agencies.
- To ensure a fully financeable final decision the Commission instead needs to set an appropriate cost of capital allowance.

[48] CMA, Anglican Water Services Ltd, Bristol Water plc, Northumbrian Water Ltd and Yorkshire Water Services Ltd Price Determinations, Summary of Final Determinations, March 2021.

DublinAirport

Dublin Airport's response CAR Draft Decision 2022

10

Quality of Service

10. Service Quality

10.1 Introduction

10.1.1 There has been intense scrutiny of Dublin Airport's quality of service during the recovery period of this post COVID-19 era. We wholly recognise the importance of maintaining and improving on the Service Quality Metrics (SQMs) set by the Commission. Though it is imperative that the Commission reviews particularly the concerns and proposals of Dublin Airport as detailed below and within Appendix 4.

10.1.2 We ultimately agree that it is of absolute importance to provide the highest Quality of Service (QoS) to our passengers throughout the campus, but such targets need to be realistically achievable.

10.2 Subjective Quality of Service Metrics

Passenger Care

10.2.1 Given 2022 has been the year of recovery, Dublin Airport has worked tirelessly through the challenges faced in achieving the expected passenger experience throughout the campus. Dublin Airport welcomes the inclusion of 'Ease of Movement' as we believe it will provide a more accurate measure overall satisfaction as opposed to 'Walking Distance'.

10.2.2 Upon review of the specific targets set for cleanliness in toilets and washrooms, Dublin Airport supports a high target. Notwithstanding that, we believe that a target of 8.5 for 2023 is unrealistic, supported by a median score of 8.4 over the past 10 years with most of this period outside of COVID-19 operational factors. We propose the Commission maintains current levels for 2023 with an agreeable review for 2024.

Passenger Information

10.2.3 The proposed target for 'Ground Transport Information on Arrival' of 8.0 for 2023, is considered and welcomed by the Commission. Notwithstanding that, 8.5 for 2024 presents a noticeably large difference, which brings with it concern as factors outside of Dublin Airport's control can impact on this (as detailed within Appendix). We would aim to raise such standards going forward once sufficient historical data is developed and an agreeable quantified standard can be benchmarked.

Bonus and Penalties

10.2.4 The introduction of bonus in addition to the existing penalty adjustments is well received by Dublin Airport, incentivising an improvement throughout service levels. Through a historical review of performance to each section we ask the Commission to implement such scheme

through a balanced approach. The bonus targets proposed below, have been based on the highest scores achieved by Dublin Airport relative to each metric.

TABLE 10.1 SERVICE QUALITY METRICS - PROPOSED BONUS THRESHOLDS RESPONSE

Metric	CAR Draft Proposal 2023-2026		DAP Response/Proposal 2023-2026	
	Target	Bonus	Target	Bonus
Passenger Care				
Additional assistance	9.0	9.5	8.9	9.3
Helpfulness of security staff	8.5	9.3	8.5	9.1
Helpfulness of airport staff	8.5	9.3	8.5	9.2
Cleanliness of terminal	8.5	9.2	8.5	9.0
Overall satisfaction	8.5	9.3	8.3	8.7
Cleanliness of toilets	8.5	9.2	8.1	8.6
Satisfaction with departure gates	8.0	9.0	8.0	8.7
Ease of movement	8.0	9.0	8.0	8.9
Passenger Information				
Finding your way around	8.5	9.0	8.5	9.0
Flight information screens	8.5	9.0	8.5	9.0
Ground transport information on arrival	2023 - 8.0 2024-2026 – 8.5	2023 - 8.5 2024-2026 – 9.0	Retain 2023 8.0, though review 2024 score based on annual performance as there is no previous history to base analysis on	Retain 2023 8.0, though review 2024 score based on annual performance as there is no previous history to base analysis on
Passenger Facilities and Services				
Facilities for passengers who require additional assistance	9.0	9.5	9.0	9.5
Availability of trolleys	8.5	9.0	8.3	9.0
Satisfaction with Wi-Fi	8.5	9.0	8.5	9.0
Sense of safety for my health	No Target	No Target	N/A	N/A

Methodology

10.2.5 The Commission has called upon Dublin Airport to input suggestions on new data collection techniques for 'Ground Transport Information on Arrival', due to anomalies with the previously proposed method.

10.2.6 Through close collaboration with our designated independent research agency, Dublin Airport proposes a dual methodology, syncing the overall results of two methodologies. As detailed in Appendix 4, these would include an online omnibus survey along with a physical on campus survey. In ensuring the validity of the results, the associated data would see a quality verification process applied. Frequency of conducting such surveys will be welcomed, though the objective would be to supply quarterly results like other QoS metrics.

Performance Challenges 2022

10.2.7 As detailed within the analysis included in Appendix 4, the following challenges were faced within our QoS metric throughout the recovery period of summer 2022:

QoS Performance Challenges 2022:
Accelerated recovery of passenger volumes, heightening pressure on facilities including washrooms and F&B units
Resourcing challenges faced across Dublin Airport and third-party service provides including those of Hygiene and F&B teams
Passenger profile and presentation greatly affected Hygiene standard as with the evolving travel issues throughout the summer, large volumes of passengers presented extraordinarily early due to expected lengthy queue times. A high percentage of these passengers were Irish residents travelling for leisure who exercise a greater use on facilities and tend to prove more critical than non-Irish residents
The development of individual's expected level of hygiene dramatically increased throughout the pandemic, there is evidently now greater concern on cleanliness particularly in densely populated areas. This has led to harsher critique and opinions of standards that would've been acceptable to passengers in a pre-COVID-19 era

10.3 Objective Quality of Service Metrics

10.3.1 The Objective QoS metrics responses have been condensed within the tables below, though these have been expanded on throughout within the relative sections of Appendix 4:

- **TABLE 10.2 DUBLIN AIRPORT AVAILABILITY PRM PROPOSAL RESPONSE**

Dublin Airport's Availability PRM						
Metric	**CAR Draft Proposal 2023-2026**		**Price Cap**	**DAP Response/ Proposal 2023-2026**		
	Pre-advised	**Non pre-advised**	**Target**	**Pre-advised**	**Non pre-advised**	**Target**
If a passenger presents for assistance at an external point within the airport campus they should be assisted to the appropriate terminal reception point as follows:	98% within 10 min	98% within 20 min	Annually -€0.01	No Change		
Breach if the percentage of passengers assisted from the terminal reception point is lower than the targets as follows:	95% within 15 min 98% within 20 min	95% within 20 min 98% within 30 min		No Change		
Breach if the percentage of passengers that are assisted from aircraft to terminal holding point onwards is lower than the targets as follows:	93% within 10 min 98% within 15 min	93% within 15 min 98% within 20 min		No Change		
Back Stop Target						
Breach if the percentage of passengers that are assisted from aircraft to terminal holding point onwards is lower than the targets as follows:	90% within 15 min 91% within 20 min	None	Annually -€0.01	No Change		

-

- **TABLE 10.3 DUBLIN AIRPORT MAX SECURITY QUEUE TIME PROPOSAL RESPONSES**

Dublin Airport's Max Security Queue Times			
CAR Draft Proposal 2023-2026		**DAP Response/Proposal 2023-2026**	
Target	**Price Cap**	**Target**	**Price Cap**
Less than 20 minutes for less than 70% of the time but less than 30 minutes 100% of the time	-€0.005	Less than 20 minutes for less than 70% of the time but less than 30 minutes 95% of the time	No Change
Equal to or greater than 30 minutes but less than 45 minutes, at any time	-€0.01	Equal to or greater than 30 minutes but less than 45 minutes 95% of the time	No Change
Equal to or greater than 45 minutes, at any time	-€0.02	No Change	No Change

- **TABLE 10.4 DUBLIN AIRPORT AVAILABILITY OF ASSETS PROPOSAL RESPONSE**

Dublin Airport's Availability of Airfield and Terminal Equipment				
Metric	**CAR Draft Proposal 2023-2026**		**DAP Response/Proposal 2023-2026**	
	Target	**Price Cap**	**Target**	**Price Cap**
T2 Passenger-facing escalators, travellators and lifts	99% average across units	<98%: Quarterly -€0.01 >=98% but <99%: Quarterly -€0.005 All From Q1 2023	No Change	<98%: Quarterly -€0.005 From Q1 2023 <99%: Quarterly -€0.005 From Q3 2023
Fixed Electric Ground Power (FEGP)	For new units, 93.5% available on average in the first year. For all other units, target of 99%	<98%: Monthly -€0.01 >=98% but <99%: Monthly -€0.005 All From Q1 2023	No Change	<98%: Monthly -€0.005 From Q1 2023 <99%: Monthly -€0.005 From Q3 2023
Advanced Docking Guidance System (AVDGS)	For new units, 93.5% available on average in the first year. For all other units, target of 99%	<98%: Monthly -€0.01 >=98% but <99%: Monthly -€0.005	No Change	<99%: Monthly -€0.005 From Q1 2023

Dublin Airport's Availability of Airfield and Terminal Equipment				
		From Q1 2023		
Self-service check-in kiosks and bag drop machines	Average of 99% availability across units	<98%: Quarterly -€0.01 >=98% but <99%: Quarterly -€0.005 All From Q1 2023	No Change, though consideration of the Commission to applicable exemptions as detailed within Appendix 2	No Change
Baggage - Inbound and Outbound	On implementation of HBS3, belt access available within 30 minutes of request	Per event -€0.01	No Change	No Change

10.4 Conclusion

10.4.1 If the service quality metrics are to be achieved Dublin Airport must have adequate investment through the Capital Investment Programme and operating expenditure allowances. Driving reductions in allowances will have direct consequent degradation in experience for passengers. This would not maximise customer welfare. Customers want service back to pre-COVID levels, which matches the Commission's approach in the Review. Passengers place quality and reliability of service and experience ahead of the minimum charge. Numerous passenger surveys have shown that the travelling public, regardless of understanding of airports price control application are willing to pay more for better service quality in the airport[49].

10.4.2 Furthermore, the NERA Willingness to Pay report[50], undertaken as part of the Commission's 2014 Determination process provided that passengers were willing to pay certain amounts for tangible improvements. Although as to be expected, the level of willingness and acceptable amounts differed depending on airline, reason for travel, party type etc.

[49] FTI Consulting, Review of Consumer Acceptability Testing Research, October 2021.
[50] NERA, Willingness to pay for improvements to Dublin Airport Terminal 1, July 2014.

Service Quality Chapter Summary:

- Quality of Service at Dublin Airport gauges and demonstrates the performance of standards and services delivered to customers, from airline to passengers.
- Subjective metrics detailed above analyses the overall quality, as expressed by people passing through the campus by surveying their thoughts and opinions.
- Objective metrics project quantifiable data, detailing the overall performance of the individual metrics vs the set targets. This is performed via the use of specific platforms and software.
- We ask the Commission, to reflect and account for the rationale of the responses we have proposed above which we believe adequately represent a balanced approach in both achieving set targets alongside delivering an appropriate standard of service.
- Quality of Service areas and metrics are discussed in depth within Appendix 4 of this document.

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Dublin Airport's response
CAR Draft Decision 2022

11

Conclusion

11. Conclusion

11.1.1 This document and its accompanying appendices constitute Dublin Airport's response to the 2022 Draft Decision. We believe that it is crucial that the material set out herein should be taken into account by the Commission in formulating its 2022 Final Interim Review Decision regarding the maximum level of airport charges at Dublin Airport for the regulatory period 20203- 2026.

11.1.2 The Commission's current pricing proposals do not provide sufficient funds for Dublin Airport to return to resilient operation post COVID-19. The aviation industry is going through an uncertain, volatile recovery from a shock that has caused significant disruption to operations and to finances globally. Steady state functioning will take time to achieve, and Dublin Airport faces the challenge of restoring service levels and reliability for customers while delivering on a multibillion-euro airport improvement programme. We have the lowest charges of our peer competitors in Europe and will continue to do so even after the modest increase we have proposed, which will significantly improve the airport experience for all stakeholders.

11.1.3 Key to achieving our strategic goals maintaining Dublin Airport's resilience whilst continuing to meet the travelling publics expectations is an appropriate price cap aligned with the 2022 Regulatory Proposition. It is crucial the Commission understands the direct implications of a lower price settlement in its final 2022 Interim Review Decision and how this is likely to ultimately prejudice the delivery of Dublin Airport's strategic goals.

11.1.4 Dublin Airport needs to be financeable, but the building block allowances in the draft decision deliver revenues and cash flows that collectively do not support financeability. The Commission's own assessment recognises this. We believe that the Commission needs to re-examine its approach to the regulatory building blocks and ensure adequate allowances for each of the regulatory variables in order to allow for a viable and operationally efficient Dublin Airport over the next regulatory determination period.

11.1.5 On this basis, we would request that the Commission reviews its current approach to the building blocks in its Final 2022 Interim Review Decision taking account of the following.

Passenger Forecasts

- Dublin Airport believe that the methodology that the Commission have undertaken to forecast passenger traffic is rational if it is transparent and the correct variables are considered.
- The Commission's output of the forecast, while plausible, is a very high scenario and with all of the current risks, as outlined, it is not realistic to achieve.
- The risks to traffic have only heightened since the regulatory submission with inflation and interest rates rising, cost of living increasing and the price of fuel remaining high.

- Despite this negative outlook, Dublin Airport have proposed an updated forecast, which increases the years 2022-2024. Normal growth will return to 2025 & 2026, with these years remaining similar to the previous forecast culminating in 34 million in 2026 (Dublin Airport have added 5.15 million passengers to their forecast
- The latest iteration of the ACI Europe forecast, while possible for all European airports combined, is not a realistic target for Dublin Airport, with 2026 forecasted to reach 118% of 2019.

Operating Costs

- The Commission's draft decision on opex does not reflect the current context for Dublin Airport.
- The 2022 Draft Decision will result in an opex deficit of [redacted] over 4 years this will not allow for a resilient airport operation.
- Alternatively, Dublin Airport is forecasting a required opex allowance of [redacted] in 2023 [redacted] in 2026.
- The granularity of CEPA's approach to opex means there are a very large number of decisions made, many of which err on the side of being too conservative/stringent. These combine to set an unachievable challenge for airport operations.
- The Commission should not set out to simply minimise the notional cost base of airport operating in a "steady state" but must consider the operating cost allowance needed for an efficient and effective operation.
- Dublin Airport must be allowed additional headroom / allowances in relation to FTE count and wage inflation assumptions, taking into account the unique future challenges ahead.

Commercial Revenues

- In its 2022 draft decision, the Commission has set ambitious commercial revenue targets with total revenue forecast to grow from €281m in 2019 to €319m in 2026.
- Dublin Airport believes that in the 2022 Draft Decision, the commercial revenue projections set by the Commission are based on an unachievable revenue per passenger targets.As per our 2022 Regulatory Proposition, Dublin Airport has projected total commercial revenues of [redacted]
- The Commission's final commercial revenue forecast needs to take account of the current falling consumer sentiment which is likely to negatively impact our commercial revenue yields going forward.
- There are a number of supply-side constraints and capacity shortages that are likely to render revenue growth less responsive to passenger traffic increases.
- A number of factors have combined to render the Commission's commercial revenues highly ambitious and potentially difficult to achieve over the period 2023-2026 thereby exposing Dublin Airport to further business risk.

Cost of Capital

- NERA carried out a review of the Commission's proposed cost of capital allowance proposed in the 2022 Draft Decision. This review identified a number of errors and flaws in the Swiss Economics methodology which was used by the Commission in its proposed WACC allowance for Dublin Airport over the period 2023-2026.
- We believe that a correction of the errors and flaws in the Swiss Economics study will lead to a higher WACC allowance for Dublin Airport.
- We believe that a more realistic WACC allowance in the range of 5.26% to 6.18% is required for 2023-2026 at a minimum.
- An adequate rate of return for the regulated entity for 2023-2026 is the only economically sound alternative the Commission has to ensure the viability of the regulated entity.

Capital Costs

- Dublin Airport welcomes the fact that the Commission is supportive of the revised CIP+2020 and that the Commission is proposing to provide an allowance for almost all the projects set out in this investment programme.
- Dublin Airport is disappointed that the pro-rata treatment proposed in our 2022 Regulatory Proposition for capital investment has not been introduced by the Commission.
- We firmly believe that a specific adjustment should be made to the opening RAB for 2023 to allow for the recovery of a portion of revenues lost as a result of the pandemic.
- We are concerned that a mechanism to allow for construction inflation has not been permitted in this Draft Decision, given that this is a serious factor that could threaten our overall CIP delivery.

Financeability

- The Commission has correctly identified a financeability constraint within the 2022 draft pricing decision. The Commission correctly targets a BBB+ credit rating to assess the financeability of the Draft Decision.
- In terms of financial ratios, Dublin Airport recommends targeting a <4.0x Net Debt / EBITDA metric as it: aligns with S&P's methodology, protects the overall financeability of Dublin Airport against the coming increase in interest rates and aligns with peer airport targets.
- The financeability sensitivity analysis performed by the Commission is incomplete. This has resulted in a price control determination that does not provide the right buffer to meet key financing ratios and an inaccurate assertion that the Draft Decision is financeable at a BBB+ rating.

- Dublin Airport's robust sensitivity analysis shows that the current pricing decision does not meet the financeability requirements in the mean scenario, and that pricing in line with Dublin Airport's original proposition is required to ensure a financeable price determination.
- The Commission is proposing using accelerated depreciation to ensure financial viability. Accelerated depreciation is not the appropriate mechanism for a financeability adjustment, it borrows from the future and as such is often discounted by borrowers and rating agencies.
- To ensure a fully financeable final decision the Commission instead needs to set an appropriate cost of capital allowance.

Service Quality

- Quality of Service at Dublin Airport gauges and demonstrates the performance of standards and services delivered to customers, from airline passengers.
- Subjective metrics analyses the overall quality that people whom pass through the campus experience by surveying their thoughts and opinions.
- Objective metrics project quantifiable data, detailing the overall performance of the individual metrics vs the set targets. This is performed via the use of specific platforms and software.
- We ask the Commission, to reflect and account for the rationale of the responses we have proposed which we believe adequately represent a balanced approach in both achieving set targets alongside delivering an appropriate standard of service.

11.1.6 As well as it being legally necessary to give adequate consideration to Dublin Airport's submissions on these points, we also note that In line with the Irish Public Consultation Principles & Guidance, the Commission should give due consideration to Dublin Airport's submissions to ensure that the real-world impact of policy options is considered.

11.1.7 Dublin Airport would welcome the opportunity to further detailed engagement with the Commission and their respective consultants ahead of the final 2022 Review Decision publication.

Appendices

DublinAirport

September 2022

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