

Dublin Airport- Regulatory Proposition – Overview 2015-2019

April 2014

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EXECUTIVE SUMMARY

Opening comment

- Dublin Airport hereby presents our Regulatory Proposition for the period 2015-2019. In doing so, we report on the outturn over the course of the current determination period, 2010-2014. This has been a very challenging period, with economic conditions remaining tough at home and abroad. The period has been one of deep cost cuts, rationing of capital spend, management of debt levels, and intensive efforts to maintain and generate revenue in aeronautical and commercial markets.
- The period has also had its positive aspects. In 2011, Dublin Airport succeeded in growing passenger traffic for the first time since 2008, and this positive trend accelerated in 2012 and 2013, with traffic growth performances of 2% and 6% respectively. **However cumulative volumes over the period 2010-2014 are expected to be more than 6m passengers less than the CAR forecast at an aeronautical revenue cost to daa of more than €60m.**
- In this Regulatory Proposition document, we describe in detail our traffic forecasts, our proposals for efficient operating cost and for developing commercial revenue for the period ahead. We similarly present our capital development and pricing proposals. Emerging from the severe economic downturn, with positive growth momentum underway, daa believes that now is the time for investing in the future of Dublin Airport and of the aviation sector in Ireland.

Customer service

- The customer is at the core of what we do in daa. It is the customer's perception of what is good that really matters. Customers who are well served and satisfied with Dublin Airport will help make the business a success. Understanding customer needs, wants and expectations, bal-

ancing requirements of various users and delivering the optimal outcome having regard to efficiency, safety and economic and environmental sustainability is therefore integral to the future. This requires a sustained focus on service quality standards. **Dublin Airport has been on a significant journey over the past five years: from a position of scoring the lowest level of customer satisfaction among almost 30 peer airports in Europe in Q2 2006, we have now scored in the Top 5 airports in all of the last four quarters.**

- Given our ongoing commitment to delivering a quality



customer experience, daa supports the retention of the existing service quality target regime.

- daa believes that passenger welfare and preference should be given more emphasis in regulatory decision-making. Passengers have the classic characteristics of a stakeholder group whose interests are likely to be neglected, namely they form a large, anonymous, heterogeneous, dispersed group, with no collective organisation or rep-

resentation. Nevertheless, passengers are the ultimate consumer whose welfare is to be served by the outcomes which regulation targets. Passenger welfare is also a crucial factor in determining passenger spend, which in turn feeds the commercial revenue which subsidises airport charges.

Traffic forecasts

- While 2013 was a successful year for traffic growth at Dublin Airport, with 6% growth, the outturn figure of 20.2m passengers is still significantly off the peak level of 23.5m passengers in 2008.
- In forecasting passenger volumes for the 2015-2019 period, daa has pursued a transparent approach, commencing with a consultation with airlines in the second half of 2013 with regard to methodology and forecast values. This step led to the publication in 2013 of an Initial Range Forecast, which airlines had a further opportunity to comment on. The forecast has now been revised and the Revised Range Forecast is published herewith. **The Revised Range Forecast includes Low, Core and High scenarios, which see passenger levels growing to between circa 22m and 24.5m by the end of the Determination period in 2019.**
- We are careful to emphasise the difficulty of forecasting accurately – whoever is doing it, with the intrinsically volatile nature of traffic patterns, particularly given the fragile economic situation both in Ireland and in key source markets.

Operating efficiency

- As part of our preparation for the regulatory determination, daa engaged Booz & Company ('Booz') to analyse independently, through 'bottom-up' analysis and comparative benchmarking, the efficiency of operational processes at Dublin Airport, and to produce a forecast of efficient operating cost at Dublin Airport for the period 2015-2019.

- **The Booz analysis indicates that Dublin Airport provides a high quality service at an efficient cost. Dublin is shown in the lower quartile of the peer group in terms of cost per pax and among the highest performers in terms of service quality.**
- This document outlines that daa implemented substantial opex cuts at the start of the current Determination period. There are now significant upward pressures on costs, including (i) pressure on pay levels as the economy returns to growth, (ii) increased security compliance costs; (iii) increased pension costs arising from resolution of the IASS pension scheme¹ and the establishment of a new DC pension scheme; and (iv) energy price inflation.
- Due to these upward pressures, the Booz report sees efficient operating costs rising from €200m in 2014 to approximately €218m by 2019 (real terms). However, opex per pax will remain flat in nominal terms over this period and decline by approximately 1% in real terms.

Commercial income – Subsidy to the Regulatory Till

- In 2013, commercial businesses at Dublin Airport delivered a net subsidy (after related operating expenses) of €80m per annum to airport charges. Over the period 2010-2014 this subsidy will have totalled circa €400m.
- On-going management and development by daa of its commercial businesses is necessary to maintain existing income levels and achieve growth. Future revenue streams are reliant on continued engagement with changing customer needs and preferences, timely investment, and an on-going commitment to innovation.
- daa is optimistic about the long term growth that can be driven in commercial incomes. At an overall level, commercial incomes are projected to increase from €128m in 2013 to to €138m in 2019 in real terms. This represents an increase of 8% in real terms.

Capital remuneration

- The Regulatory Proposition discusses a number of issues under the heading of 'Capital remuneration', including (i) reconciliation of 2010-2014 capex, (ii) reconciliation of T2

and T2 Associated projects, (iii) admission of T1X capex to the RAB, (iv) T2 remuneration profile and (v) weighted average cost of capital for Dublin Airport.

- daa contends that the full value of the capital spends in question should be admitted to the RAB and highlights the fact that CAR's capex principles are unduly restrictive in terms of their treatment of additional capital spends relative to allowance, for example by comparison with the treatment of capex by the UK airports regulator, CAA.
- daa has three main points with regard to **T2 reconciliation**: (a) that the original contingency disallowance by CAR was



inappropriate; (b) that the use of the CPI deflator (rather than construction price inflation) as a means for defining additional spend is incorrect; (c) that the actual additional spend (relative to daa's control budget) of €55m or 8% was not untypical for a capital project of this size, and that the outturn cost for the terminal was efficient, particularly given the completion within an accelerated timeframe and the problem-free opening for business.

- With regard to **T2 remuneration**, CAR's treatment has two

unusual features, namely the total deferment of a portion of the remuneration ('Box 2' – on the basis that the terminal specification was larger than required) and unitisation, which links the remuneration of the portion ostensibly not deferred with total forecast passenger flows over the life of the asset, equalising return per passenger and thus massively back-loading the capital remuneration. The negative implication of these Box 1 / Box 2 and unitised approaches for Dublin Airport's overall return on RAB and financeability metrics is highlighted below. We also disagree with these approaches even within their own frameworks, i.e. firstly that the actual peak use pattern of T2 demonstrates that the terminal was not over-specified, and secondly that the unitisation range over which Box 1 is remunerated appears illogical.

- daa commissioned NERA to provide an independent estimate of the weighted average cost of capital (WACC) for Dublin Airport for inclusion as part of the Regulatory Proposition. In summary, the NERA analysis indicates that the real pre-tax WACC for Dublin Airport should be set at between 7.64% and 7.81%, i.e. higher than the current allowed WACC of 7%. The increased range recommended by NERA reflects in particular; (i) the inclusion of a Country Risk Premium to account for the premium investors must receive to invest in Ireland; (ii) NERA's estimates of the beta for Dublin Airport, which is based on a relative risk assessment of comparator airports and change in risk since the last Determination; (iii) NERA's estimate of the cost of debt, based on daa's actual borrowings (embedded debt) and the cost of new debt based on current forward curves.

Capital investment proposals 2015-2019

- daa has undertaken a systematic approach to the identification of investment needs at Dublin Airport for the period 2015 to 2019, including (i) a risk-based prioritisation of capital maintenance requirements, consistent with ISO 55000 Asset Management Standard, towards which daa is working; (ii) an individual processor - level review of the airport capacity pipelines; (iii) identification of projects

¹ daa has circa 1,000 staff who are eligible for a new scheme which is yet to be established. daa has benefited from a lower and unsustainable level of cost in recent years prior to the initiation of this scheme.

which maintain or increase commercial revenue, with IRRs demonstrated on an individual project basis as appropriate; (iv) identification of projects necessary to fulfil regulatory requirements (including security and environmental requirements); (v) comprehensive multi-faceted engagements with airport users, including detailed consultations on a full set of capital investment proposals over a 5-month period, concluding in April 2014.

- daa's capital investment proposals are summarised later in this document and presented in detail in the technical appendix 'CIP Proposals 2015-2019'. CIP Proposals 2015-2019 contains three tranches of capital investment:
- Tranche 1 represents 'Capital Maintenance', i.e. the investment needed to maintain existing assets on an efficient basis. The total proposed investment under this tranche is €186m.
- Tranche 2 represents 'Business Development', including projects (i) to maintain existing commercial revenue streams, and (ii) to provide new assets, new efficiencies, and new revenue streams at the airport. The category (ii) spend will secure provision of the facilities and service level required to accommodate our Core traffic forecast to 2019. The total proposed investment under this tranche is €183m.
- Tranche 3 represents 'contingent' projects. These include trigger projects such as the T1 check-in and security investment proposed for T1. Other projects such as the construction of additional line-up points for runway 10-28 are contingent on business cases for the project themselves, interacting with other considerations for example the existing trigger for Northern Runway 10-28. The proposed investment under Tranche 3 is €86m.
- The final category of spend under CIP Proposals 2015-2019 is 'Other'. This includes house-keeping spend associated with the CIP ('Minor Works', 'Programme Management') and investments preparatory to Northern Runway 10-28 (including advance house buy-out funds and planning and associated fees). The total proposed investment under the 'Other' heading is €22m.

Financeability

- In making a determination, CAR is statutorily obliged 'to enable Dublin Airport Authority to operate and develop Dublin Airport in a sustainable and financially viable manner'.² The most pressing issue in this regard from daa's point of view is the need to refinance maturing debt facilities of €700m over the course of the forthcoming determination period.
- In the view of daa's financial advisors, debt market conditions will remain challenging for daa in the next regulatory period, in particular due to (i) Irish sovereign risk, and (ii) limited choice of funding options. **daa's advisors have indicated that a minimum BBB+ rating is essential for daa to have secure access to the debt markets in order to refinance its maturing debt facilities on optimal terms. This entails target ratios of FFO:Debt \geq 23% and Debt:EBITDA of 3x or less.**



Focus on regulated utility financeability

- **CAR has previously relied on the credit rating of daa group as a whole as one key assessment of whether it has met its responsibility with regard to financial viability. This, in practice, allows the regulated entity to free-ride on the financial performance of the group.** For instance, as recorded in the published audited regulatory accounts for 2012, the FFO : Net debt ratio for the regulated entity was <10%, while the same ratio for the group for 2012 was circa 19%.
- This approach on the part of CAR is inconsistent with util-

ity regulation in Ireland, which does not take into account the group metrics but rather the target regulated asset metrics for assessing financeability.

- Under CAR's current approach, if daa group excluding Dublin Airport was losing money, it would be consistent for CAR to allow Dublin Airport to earn a return exceeding its WACC in order to ensure the financeability of the daa group. In fact the proper methodology would ensure that in situations where daa group made a loss the regulated asset WACC would not subsidise non-regulated assets for financeability.
 - daa hereby calls on CAR to assume responsibility for ensuring the financeability not of daa but of the regulated entity for which it has the responsibility of economic regulation.

Sub-normal return on T2

- There is no guaranteed return in incentive regulation, but generally speaking it should be permissible for the regulated entity to make or exceed its allowed return if it meets its efficiency, revenue and service quality targets. By contrast, in the case of the regulatory regime which daa faces, even if daa exactly achieved all targets/forecasts with regard to expenditure, revenue, service quality and capex projections etc., there remains in the price-control a structural impediment to the achievement of the full allowed return within the year or indeed across the full regulatory period: namely the capital remuneration treatment of T2. **The capital remuneration of T2 offers a return structure that no competitive-market firm or privately-owned regulated utility would find acceptable and a review from first principles is merited.**

Price cap and daa's price promise

- daa is subject to market constraints in respect to its pricing. It is subject to significant competitive pressures from other airports, through airlines' demonstrated ability to shift capacity and from the countervailing buyer power

² State Airports Act 2004, section 22, sub-section 4.

exerted in particular by our two largest customers, who together account for more than 80% of traffic at Dublin Airport.

- In the course of the current determination, daa has chosen, in specific years, to price below the cap precisely because of its belief that lower pricing would be more beneficial to the market.
- daa believes that an appropriate price-cap for the period 2015-2019 would average slightly below €13.50 per passenger (real terms - versus the current level of €10.68). This would reflect a fair, efficient price-cap, derived from adherence to an evidence-based application of the building-block approach. Note that a price-cap of less than €13.50 would still be below the observed average price in the relevant market segment in 2012.
- In daa's view, a price-cap at the above level represents the appropriate maximum price (which would protect the market from the theoretical possibility of monopoly pricing). However arguing for a price cap of circa €13.50 per passenger is not synonymous with saying that prices would rise to that level. In fact, daa proposes to make a strategic investment in the market through pricing below a fair cap.
- **Working off our Core passenger forecast, daa intends to retain pricing broadly at current levels in real terms. daa believes it is possible to price below the cap in this way and deliver the capital programme herewith submitted.**
- daa believes that further growth may be stimulated by additional highly-targeted volume-related discounting (focussing on incremental passengers above pre-defined thresholds), and we would expect to be consulting early with our airline customers in this regard, subject to the content of CAR's Determination.
- daa believes that the setting of an appropriate price cap will provide an opportunity to demonstrate that market conditions will control the price. This was observed in the case of Stansted, where the market price has been systematically lower than the price-cap. It would be very much in daa's interest to deliver on a pre-determination promise with regard to pricing, as this would sup-



port future arguments for an evolving approach to price cap regulation, for example in the direction of the less intrusive regime envisaged under the European Airport Charges Directive.

1. Opening comments

Connectivity is essential in the international marketplace. This is particularly the case for Ireland as a small open economy positioned on the western tip of Europe. Air access is critical for Ireland's economic development. Dublin Airport's pre-eminent position in the Irish aviation sector delivers the critical mass required to attract the necessary services to key short and long haul destinations for both business and leisure markets. Direct connections are essential for both expanding Irish export trade and growing foreign direct investment in Ireland. Dublin Airport is also a key gateway for Northern Ireland.

Few European airports can match Dublin Airport's connections to Ireland's established markets of Britain and the United States. In addition Dublin Airport is developing its European links and expanding into the Middle East region and beyond.

Dublin Airport is a vital element of national infrastructure, a pivotal contributor to on-going activity, and a key facilitator of economic development. There is therefore a responsibility on those of us who are key players in the regulatory process to be mindful of medium-term national development concerns, as well as immediate commercial concerns.

Dublin Airport hereby presents our Regulatory Proposition for the period 2015-2019. In doing so, we report on the outturn over the course of the current determination period, 2010-2014. This has been a very challenging period, with economic conditions remaining tough at home and abroad and with passenger numbers more than 6m below what was forecast by CAR at the time of the last Determination. The period has been one of deep cost cuts, rationing of capital spend, management of debt levels, and intensive efforts to maintain and generate revenue in aeronautical and commercial markets.

The period has also had its positive aspects. In 2011, Dublin Airport succeeded in growing passenger traffic for

the first time since 2008, and this positive trend accelerated in 2012 and 2013 with traffic growth performances of 2% and 6% respectively. **Long haul traffic has become increasingly important at Dublin, with the expansion in transatlantic connectivity and capacity producing a record 1.9 million transatlantic passengers in 2013. In addition there has been expansion into the Middle East market with an increase in services out of Dublin Airport offered by Etihad and the commencement of operations by Emirates creating the possibility of onward connections to Africa, India, Southeast Asia and Australia.** Against this, the Irish market has seen almost the complete withdrawal of domestic air services during this period (a market that peaked in Dublin Airport at 890k passengers in 2007 – down to 65k in 2013).

The above expansions were made possible by the successful opening in 2010/2011 of T2 and a new US pre-clearance facility ('CBP') within the terminal. **Exploiting the opportunity thus created, daa focused on the development of the transfer market out of Dublin, resulting in 36% growth in transfer traffic in 2013.** We have continued to stimulate growth in traffic by proactively marketing Dublin Airport and providing market-leading incentive schemes to share the risk of launching new services and to reward airlines which grow their business at Dublin Airport. These incentive schemes provided discounts on what were already highly competitive airport charges in an effort to encourage new route development and support overall traffic growth.

Our focus on customer service has been relentless. Our objective is to deliver a quality airport travel experience to the best international standards, and this had led to improving quality results over the period. As Figure 1 evidences, Dublin has outperformed the customer satisfaction targets set by CAR in the 2009 Determination and we are featuring consistently now in the Top 5 airports in the

ACI survey.

Figure 1: Passenger Overall Satisfaction with Dublin Airport



Dublin Airport is a fully commercial business that receives no funding or financial support from the State. The airport is funded through a combination of airport charges and the revenue that the company generates from its own retail activity, car parking, property rentals and other commercial income. Despite our success in growing passenger numbers while driving down costs, Dublin Airport – as a regulated business – remains under intense profitability pressure, with return-on-assets and financeability metrics below normal commercial levels. This is clear from the summary of the financial performance of the regulated entity for the years 2010 to 2012:

Table 1: Summary Financial Performance of the Regulated Entity

Year	2010	2011	2012
Passenger Numbers	18.4m	18.7m	19.1m
Commercial Revenues ³	€121m	€122m	€127m
Operating Expenses	€173m	€181m	€186m
Capital Expenditure	€31m	€67m	€26m
Return on RAB ⁴	7.1%	3.4%	3.6%
PAT (pre exceptionals)	€25m	-€0.4m	€3.5m
FFO: Net Debt	9%	8%	9%

2013 results will be available when the daa Annual Report for 2013 is published.

In 2011 and 2012, the return earned on the Dublin Airport RAB was more than 3% **below** the CAR allowed return of 7%. This was caused by CAR's deferral of remuneration on T2. In order to earn the full return Dublin Airport would have required an additional €47m to €54m in earnings. In passenger terms, this would have required an additional 4.2m (22%) passengers annually which would have seen Dublin Airport exceed CAR's passenger forecast by 14%.

Naturally, the purpose of this document is ultimately forward-looking. We describe in detail our traffic forecasts, our proposals for efficient operating cost and for developing commercial revenue. We present our capital development and pricing proposals for the period ahead. **Emerging from the severe economic downturn, with positive growth momentum underway, daa believes that now is the time for investing in the future of Dublin Airport and of the aviation sector in Ireland.** We believe that the pillars of this investment are:

- Systematic, economic maintenance of the existing assets and development of new infrastructure to accommodate growth;
- Professional exploitation of commercial opportunities;
- Efficient processes and operating costs;
- Competitive aeronautical pricing, including market-leading discount incentives for new routes and increased volume on existing routes;

³ Commercial revenues includes hangar income, income from the former Clarion Hotel site and property rental income that daa proposes to bring forward for exclusion from the till.

⁴ CAR allowed regulated rate of return 7%.

- Tireless customer focus in everything we do.

2. Structure of Regulatory Proposition - Overview

This document represents an overview. A more detailed regulatory proposition document will be available to stakeholders subject to completion of a non-disclosure agreement and following publication of the daa 2013 Annual Report in May 2014.

This document is structured as set out below.

EXECUTIVE SUMMARY

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2. Structure of Regulatory Proposition - Overview
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3. Determination process

Under the Aviation Regulation Act 2001 (as amended), the Commission for Aviation Regulation (CAR) has responsibility for '*specifying the maximum levels of airport charges that may be levied by . . . Dublin Airport*'. CAR fulfils this responsibility through making a 'Determination', which must run for a period of not less than 4 years. In practice, CAR's determinations have been specified to run for 5-year periods. The current determination period runs from 2010 to 2014. The next determination period is expected to run from 2015 to 2019.

In making a determination, CAR's objectives, as set out in the legislation are:

- to facilitate the efficient and economic development and operation of Dublin Airport which meet the requirements of current and prospective users of Dublin Airport;
- to protect the reasonable interests of current and prospective users of Dublin Airport in relation to Dublin Airport; and
- to enable Dublin Airport Authority to operate and develop Dublin Airport in a sustainable and financially viable manner.

The legislation also requires that CAR, in fulfilling its responsibilities relating to airport charges, shall have regard – inter alia – to service quality, operational efficiency and investment requirements.

As required under the legislation, in arriving at its pricing determination, CAR follows a consultative process, in which it is open to all interested parties to make submissions to CAR on the subject of maximum airport charges at Dublin Airport and associated issues. The consultation process follows a series of established steps, as follows:

- i) **CAR publishes its Issues Paper**, setting out questions of principle with regard to its approach to the price determination and inviting comments from interested parties. For the current determination process, CAR published its Issues Paper at end July 2013, with a deadline for comments from interested parties by 30 September 2013. daa was one of the respondents to CAR's Issues Paper.
- ii) **daa submits its Regulatory Proposition and proposed Capital Investment Programme (CIP) to CAR for the forthcoming determination period.** The Regulatory Proposition contains daa's recommendations as to the passenger, operating cost and commercial revenue forecasts which CAR should use in setting maximum prices for the determination period. The Regulatory Proposition also contains daa's proposals

on other important factors affecting future pricing, including capital investment allowances (past and future), the remuneration treatment of capital allowances, including depreciation policy and weighted average cost of capital (WACC), and customer service requirements. This current document constitutes an overview of daa's Regulatory Proposition for the period 2015-2019. The Regulatory Proposition document and the CIP Proposals 2015-2019 have been submitted to CAR.

- iii) **CAR publishes its Draft Determination**, setting out its initial view on what the maximum level of airport charges should be over the determination period and inviting comments from interested parties on this initial view. CAR is expected to publish its draft determination at end May 2014, with comments due back by end July;
- iv) **CAR publishes its Final Determination**. This represents CAR's final decision on maximum pricing for the forthcoming period, although the legislation does allow for appeal, at the Minister's discretion. In previous determination processes, the appeal mechanism has generally been invoked by one or more parties.

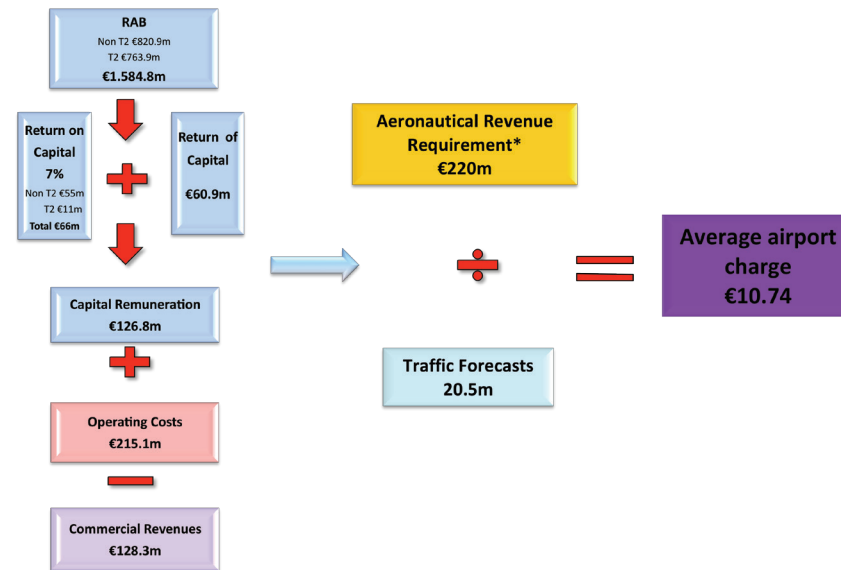


The findings of the appeal panel – as set up by the Minister – are considered by CAR, but it is wholly within CAR's discretion to decide whether and how it amends its final determination in the light of any findings of the appeal panel.

4. Structure of price-cap

The previous section described CAR's legal responsibility in regard to airport charges and outlined the regulation determination process. This section summarises the structure of the price cap, as currently operated by CAR.

Figure 2: Derivation of 2012 Price Cap



The form of maximum price control chosen by CAR is a cap on the average charge per passenger. Figure 2 above shows how this mechanism works, using the 2012 price cap as an example. This is a 'building blocks' approach. A description of the building blocks and how they are combined in arriving at the final price cap is given below.

4.1 Capital remuneration

- The starting point for the capital remuneration build-

ing block is the RAB or Regulatory Asset Base. This can be thought of as the full (indexed) value of the assets which CAR allows Dublin Airport to be remunerated on through airport charges. Capital remuneration has two components: return of capital (depreciation); and return on capital.

- CAR applies three different approaches to **return of capital** from the RAB. The first, relating to pre-2009 assets, is straight-line depreciation of RAB value, indexed to adjust for inflation. The second, relating to general capex from 2009 onwards, is an annuitized approach, essentially similar to a standard domestic mortgage in that the payment remains constant over the life of the return, with a decreasing component of interest and an increasing component of principle over time. The third, relating to T2 and associated assets, is a 'unitised' approach, which seeks to equalise remuneration not over time, but by passenger (based on an assumed passenger forecast over the life of the asset). In addition to the unitised approach, CAR has also deferred a portion of T2 remuneration entirely, labelling as Box 1 the amount to be remunerated immediately and Box 2 the amount deferred.
- **Return on capital** is calculated using the average RAB value for the year in question multiplied by the allowed rate of return, which is the WACC, as specified by CAR in its Determination decision, currently 7%.

- For a given year, the **RAB value** itself is given by the allowed closing value of the RAB in the previous year, plus half the value of the allowed capital accretions to the RAB for the year in question. This gives the average value of the RAB for the year, assuming that the allowed accretion value is added evenly over the course of the year.
- The opening value of the RAB in 2015 will be determined by the precise amounts allowed by CAR for (i)

2010-2014 capex and (ii) earlier capex for which the final RAB value has not yet been settled, namely T2, T2 Associated Projects and T1X. Accretions to the value of the RAB over the 2015-2019 period will be determined by the magnitude of capital expenditure allowed by CAR over the period, which is typically decided by reference to the CIP Proposal submitted by daa.

- While all of the building blocks are very important, it is worth drawing out the particular significance of the RAB. By allowing or disallowing capex to enter the RAB, CAR exerts defining influence on how the infrastructure at Dublin Airport is developed for present and future users. In its policies of treating variations in capex from allowance, CAR gives or denies daa flexibility to make real-time investment decisions and sets a level of financial risk. In setting the return of and return on capital, CAR exerts substantial control on the overall financial return which the regulated entity earns and the financial metrics which underpin its immediate and future viability, including impacts on the ability to raise and renew debt.

4.2 Operating costs

- CAR determines the operating costs which daa is to be allowed for the forthcoming determination period. This is straightforward in principle. In practice it can be controversial, for example if CAR would set a level of opex which daa would regard as unachievable (too low) or a level that other stakeholders would regard as too high. As part of our preparation for the regulatory determination, daa engaged Booz & Company ('Booz') to analyse independently, through 'bottom-up' analysis and comparative benchmarking, the efficiency of operational processes at Dublin Airport, and to produce a forecast of efficient operating cost at Dublin Airport for the period 2015-2019. Booz consultants have previously undertaken similar work for CAR.

4.3 Commercial revenues

- $(\text{Allowed capital remuneration}) + (\text{Allowed operating costs}) - (\text{Forecast commercial revenues})$ gives the 'Aeronautical revenue requirement'. Within this formula, it can be seen that commercial revenues earned at Dublin Airport are a direct subsidy to airport charges at a rate of 100%, i.e. every € of commercial revenue earned equates to one € less allowed to be raised through airport charges. This is the Single Till approach. It is CAR which sets the target for commercial revenues over the course of the determination period, with any shortfall relative to forecast absorbed



by Dublin Airport as a loss.

- Almost all commercial revenue earned by daa at Dublin Airport is included in the Single Till. The principal components are (i) Retail, direct and concessionary, (ii) Car parking, (iii) Commercial property and concessions, and (iv) Advertising. At present, the only exclusion from the Single Till relates to a commercial investment in an element of the hangar business which airlines were not prepared to admit to the RAB in the

last determination period. CAR's ruling allowed Dublin Airport to proceed with the investment on an ex-Till basis, meaning that the risk and return associated with the investment were ring-fenced to Dublin Airport. As part of its current engagement with airlines on capital investment planning for 2015 to 2019, daa is proposing to exclude a further programme of investment from the Single Till, namely investment relating to the property venture known in the last determination as Dublin Airport City. As consultations with the airlines on this matter are on-going, the exclusion proposal is not addressed in this document, but will be submitted later to CAR.

4.4 Traffic forecasts

- The traffic forecast is a major building block in the calculation of the allowed average airport charge per passenger. In some regimes of economic regulation, the price cap is directly linked to the revenue requirement. This allows the price to rise if volume falls, recognising that the revenue requirement will be inelastic (at least to an extent, within a given range) to volume deviations off forecast. In the case of Dublin Airport, where the price cap is set in average terms per passenger, there is no such flexibility. If actual volume falls below forecast, this translates into a loss which must be absorbed by daa. In the present system, all the volume risk is with daa, which is not in itself unacceptable, but it makes it imperative from daa's point of view that the forecast be realistic.
- Needless to say, it is impossible to predict the future with absolute certainty. Because of the many and complexly interacting determinants of passenger volume, forecasting these volumes is particularly difficult, and traffic forecasts can represent no more than informed estimates. Two examples are illustrative of this general problem. (i) Actual passenger numbers have been significantly lower than CAR's forecast for the current determination period, with a cumulative variance of circa 4.6m passengers in the period 2010-



2013. (ii) More recently, the responses from airlines to the 2013 Airport Charges Consultation suggested that traffic volumes for 2013 would be broadly the same as in 2012, i.e. 'flat'. In the event, the outturn was 6% growth.

- In daa's view, the passenger forecast for the determination period should be daa's forecast. This forecast should not be second-guessed by CAR. daa's approach to forecasting is systematic, evidence-based and drawing on a professional forecasting function which daa has built up over a number of years.
- daa has gone to considerable lengths to ensure that its passenger forecasting process has been transparent and consultative. In the second half of 2013, we consulted with airlines on both forecasting methodology and values. This led to the publication of an Initial Range Forecast, which was further discussed with airlines in the capex consultation process, including presentation of a number of scenarios: High, Low, Core; T1 High Growth; T2 High Growth (Transfers). The Initial Range Forecast has now been revised – as had

previously been signalled – in the light of latest information, and the Revised Range Forecast is the basis used in the Regulatory Proposition forecasts.

4.5 Customer service targets

- There are a number of technical adjustments to the price cap which are not described in this summary. One important further element that should be highlighted is the link with customer service targets. For the 2010-2014 Determination CAR set 12 service targets for daa to achieve, with non-achievement to be penalised through the form of reductions to the price cap. daa believes that this has been an effective mechanism in the 2010-2014 period and is supportive of its continuance.

5. Customer vision

daa is committed to customer-focussed service provision. Our frame of reference for the customer is broad, covering airlines, passengers, private and commercial users of our commercial services and other users of the airport infrastructure. In order to deliver on our customer commitment, daa engages with customers through direct day-to-day interactions, co-operative forums, formal consultations, on-going tracking studies, international benchmarking and customer complaints management. Feedback from customers facilitates daa in identifying priority issues for immediate follow-up and action. It also serves a more strategic function in identifying gaps in service delivery from a customer perspective which need to be addressed through longer-term planning, in terms of both service provision and facilities/infrastructure development.

The customer is at the core of what we do in daa. It is the customer's perception of what is good that really matters. Customers who are well served and satisfied with daa and Dublin Airport will help make the airport business a success. Understanding customer needs, wants and expectations and delivering these in a profitable, sustainable and safe manner is therefore integral to the

future success of daa. This requires a sustained focus on service quality standards. Dublin Airport has been on a significant journey over the past five years: from a position of scoring the lowest level of customer satisfaction among almost 30 peer airports in Europe in Q2 of 2006, Dublin Airport has now scored in the Top 5 airports in all of the past 4 quarters.

This improvement has been achieved by implementing significant changes across infrastructure and facilities, systems, processes, products and services, addressing issues/gaps in multiple customer touch-points and transforming how Dublin Airport is experienced by customers. This work has been underpinned by a sustained focus on understanding and meeting key customer needs as they make their airport journey and challenging ourselves to continually exceed their expectations. Service quality is seen as a key differentiator for Dublin Airport in seeking to attract new airlines and new business. To leverage this benefit daa needs to maintain its Top 5 position, at a minimum, but has a goal of reaching the Number 1 position over time. This will require continued dialogue with our customers, identifying and responding to their needs and requirements.

In 2009, CAR introduced a service quality term to the price cap formula, creating a direct link between the price cap on airport charges and the quality of service at Dublin Airport. There are 12 service measures in the monitoring scheme, with implications for the level of airport charges. Nine of the measures are based on the results of passenger surveys (ACI ASQ). The three other measures, relating to passenger security queue times and the availability of out-bound baggage and in-bound baggage systems are based on system data provided by daa.

Given daa's on-going commitment to delivering a quality customer experience, it is recommended that a service quality metrics regime be retained within the price cap structure. Specifically, daa recommends:

- that the existing 10 ACI ASQ measures should continue to be included in the CAR service quality regime and that they should be retained at the existing tar-

get levels;

- that the security queue SQM should be retained at 30 minutes, but with the 'red line', which marks the end of the existing queue measurement, moved to completion of the walk through metal detector (WTMD) screening, thus creating a more demanding metric for daa, but one which is more reflective of the complete customer experience.

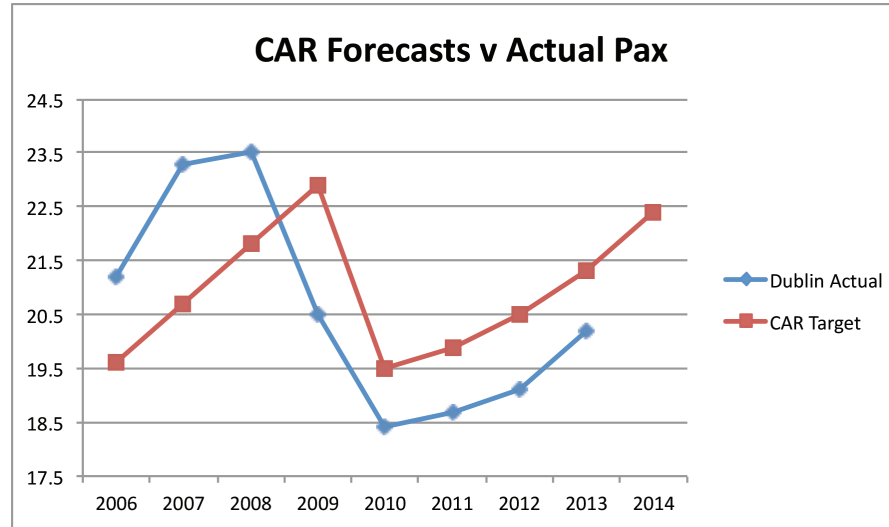
daa's consultation process with airlines in preparation for this Regulatory Proposition included detailed discussion of service quality metrics. daa suggested a broadening of the set of metrics to cover a more complete set of activities affecting customer experience. The initial response of the airlines to this suggestion was not favourable, but daa believes it is worthy of consideration by CAR. In the course of this discussion, daa also outlined that there would be opex impacts associated with any reduction of queue security target below 30 minutes.

6. Traffic performance and forecasting

6.1 Recent traffic performance

2013 was a successful year for traffic growth at Dublin Airport, with 6% growth. All the major traffic markets grew, with particularly strong growth in the long haul market (+11%), while the short haul market (+4%) drove the volume increase (+700k). As Figure 3 indicates, traffic is still significantly off its peak level of 23.5m passengers in 2008.

Figure 3: Recent Traffic Performance vs. CAR Forecast



For the purposes of the regulatory Determination process, a number of important points arise:

- Positive as recent traffic performance has been, it is still far below what was forecast by CAR at the last determination. Cumulative volumes over the period 2010-2014 are expected to be more than 6m less than the CAR forecast at a revenue cost to daa of more than €60m.
- A striking feature of recent experience has been the extent to which carriers can move capacity in response to economic conditions. Of the two carriers with large bases at Dublin, Ryanair demonstrates more variability in this regard, which would be expected given its multiple bases and its history of switching capacity, reportedly in response to airport charges and tax conditions. From its high capacity point in 2008 to its low capacity point, Ryanair demonstrated a swing of 30%. Aer Lingus, demonstrating less variability, nevertheless reduced capacity by 17% from the peak to the low point over the period. The reduction in capacity by 'Other' carriers was 44% from the peak to the low point over the period.
- While the precise price elasticity of demand for air-

port services at Dublin Airport is uncertain, it is clear that the demonstrated ability of all carriers to vary capacity must exert a competitive market discipline on daa's airport charges and the price-quality ratio of the service offering.

- As an aggregate consequence of capacity shifts in recent years, traffic at Dublin Airport is now far more concentrated on based airlines than was previously the case (86% in 2013 versus 75% in 2006). This shift has important implications. The economics of based aircraft rely on departures in the first wave, which in turn indicates a requirement for peak capacity (e.g. capacity in regard to check-in, security, stands and runway access.) It is particularly notable that the peak 60 minutes in 2013 was busier than the corresponding hour at any time in the past, including when volume peaked in 2008 at 23.5m pax.
- T2 has proved very successful in attracting airlines and passengers and now accounts for nearly 50% of traffic (with all Aer Lingus and most long haul traffic in T2). T2 is a smaller terminal than T1 and is now approaching full capacity at the peak. Accordingly, it will be necessary for T1 to become the centre of gravity for growth in the forthcoming period, and this in turn requires investment in T1, in terms of capacity enhancement to release its full potential (e.g. security and pier development), maintenance of the ageing asset, and improvement of the customer experience for both airlines and passengers.

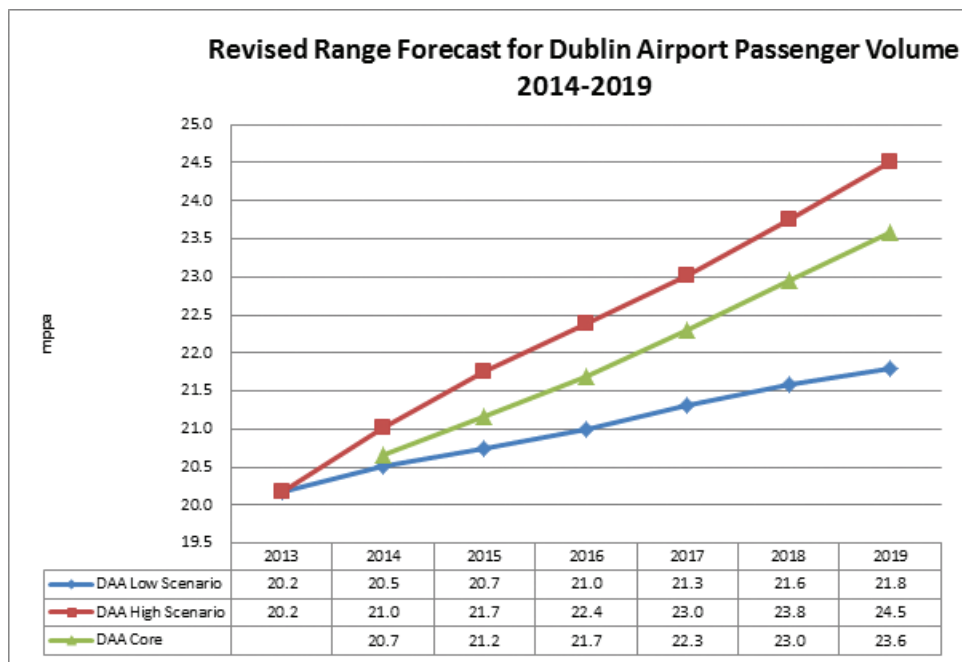
6.2 Forecasting for the next Determination

As the basis for the Regulatory Proposition, daa presents a Revised Range Forecast, as below. As described earlier, this forecast results from a transparent and consultative engagement with airlines as to both forecasting methodology and forecast values.

The outturn in 2013 exceeded expectations and the early outlook for 2014 is somewhat more positive than it was at the time that the Initial Range Forecast was published. However, we would also introduce a note of caution, par-

ticularly since the Irish, European and global economic situations remain fragile. A projection or a set of projections such as the ones presented here can give the impression of inevitability in regard to rising volumes, with only the slope of the projection as a matter for discussion. In fact, there is no such inevitability, as the experience of the last 10 years readily evidences. Projections are also typically suggestive of evenly-paced growth, when in fact growth is likely to accelerate at times and to slow down at other times. There are numerous different paths by which the same 2019 outcome could conceivably be arrived at. While the early 2014 expectation is now somewhat more positive than it was, daa does not believe that this necessarily points to a higher 2019 outcome than was predicted in our Initial Range Forecast presented last year.

Figure 4: Revised Range Forecast for Dublin Airport Passenger Volume 2014-2019



7. Operating Efficiency

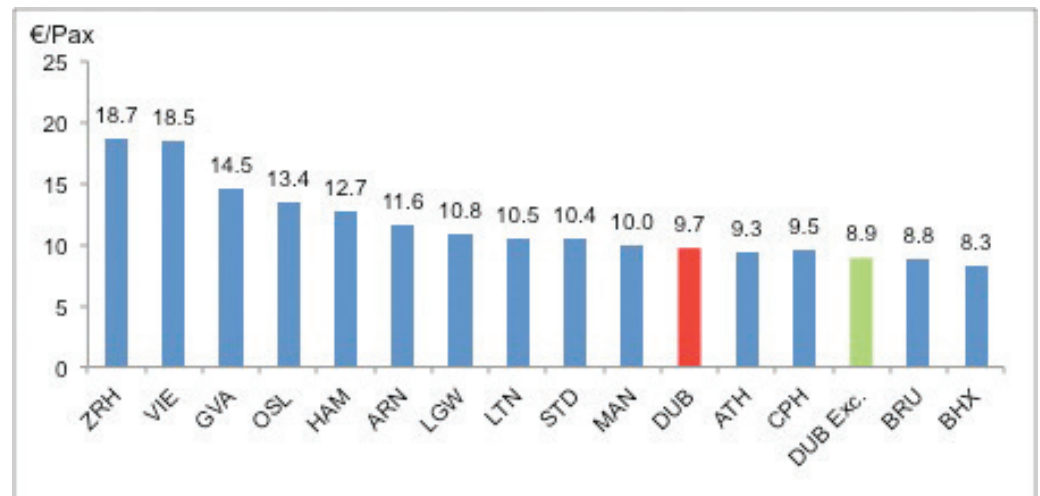
7.1 Dublin Airport provides a high quality service at an efficient cost

As measured using operating cost per passenger, the independent benchmarking analysis conducted by Booz indicates that Dublin Airport provides a high quality service at an efficient cost. Comparative cost efficiency is illustrated in Figure 5. Figure 6 highlights Dublin Airport’s comparative overall service level and shows how this has increased in recent years.

Figure 5: 2012 Operating Cost per Passenger – Comparator Airports, €



Figure 6: Passenger Satisfaction with Dublin Airport



7.2 Opex 2008 – 2014: Deep cuts in opex at height of economic downturn; Upward pressures on cost in the latter part of the 2010-2014 determination period

In dealing with the impacts of the economic downturn, and in particular in order to counteract the immediate threat to daa’s profitability and financeability (exacerbated by the CAR Determination in 2009), daa pursued a number of initiatives around the start of the last determination period which led to the achievement of substantial reductions in the Dublin Airport cost base by 2012. Chief among the measures introduced was the Cost Recovery

Programme (CRP), which led to an annual payroll reduction of €37m compared to the 2008 cost level and a further €4m relating to passenger decline. A major component of this CRP was the voluntary severance scheme (VSS) the cost of which - €59m to end 2013 - was not allowed by CAR. Other notable savings came in the area of non-pay costs and through the delivery of lower T2 pay costs than had been envisaged.

It is important to note that the achievement of these savings was made possible by the national conditions of severe economic downturn, which improved daa's purchasing power considerably in regard to new hires for T2 and rates struck with external providers (non-pay costs). Similarly, the ability of daa to negotiate pay reductions with existing employees was predicated on employee and trade union recognition of the emergency conditions of the time.

Despite the deep cost-savings measures introduced by daa, Dublin Airport has faced upward steps and strong upward pressure on cost throughout the current determination period. The opening of T2 necessarily represented a significant upward cost step, notwithstanding the fact that the rates struck were more competitive than had been estimated. As T2 costs have matured (with rising average rates and increasing maintenance opex as the terminal commences to age), this has exerted a further upward cost step. Increases in resources necessary to achieve security compliance requirements, pension cost increases, and non-pay increases have been among the other factors pushing costs upwards. Upward pressures on cost will continue into the next period, including:

- Pressure on pay levels as the economy returns to growth;
- Security – with uncertainty around the precise implications of future changes to the LAGs (Liquids and Gels) regime and the introduction of mandatory ETD (Explosive Trace Detection); There is also a general uncertainty around security requirements with the possibility of new threats emerging with attendant manpower/equipment implications;

- Increased pension costs arising from resolution of the IASS pension scheme and the establishment of a new DC scheme;
- Energy price inflation;
- Increasing Rates costs.

7.3 Regulatory Proposition opex forecast shows declining opex per pax over 2015-2019 in real terms

daa is presenting the independently-derived efficient Booz 'Baseline' opex forecast as its business forecast for the forthcoming determination period. Booz has also presented an 'Improved' scenario, based on specified efficiencies, independently derived by Booz. Given the severity of the cost rationalisation programme previously instituted by daa (in the unique economic circumstances that prevailed at the time), the scope for further opex rationalisation going forward is strictly limited. daa presents the Booz Improved scenario as a challenging target which would be a stretch for daa to achieve.

Figure 7 shows the opex forecast in real absolute terms under the Baseline and Improved scenarios assuming the Core passenger traffic forecast. The improved scenario is approx. €4m lower than the Baseline scenario by 2019, indicating a cumulative saving of €18m over the Determination period. Figure 8 summarises in real terms the opex/pax relationship, which is seen to fall by approx. 1% per annum over the period in compound average terms.

Figure 7: Projected Dublin Airport OPEX (real terms)

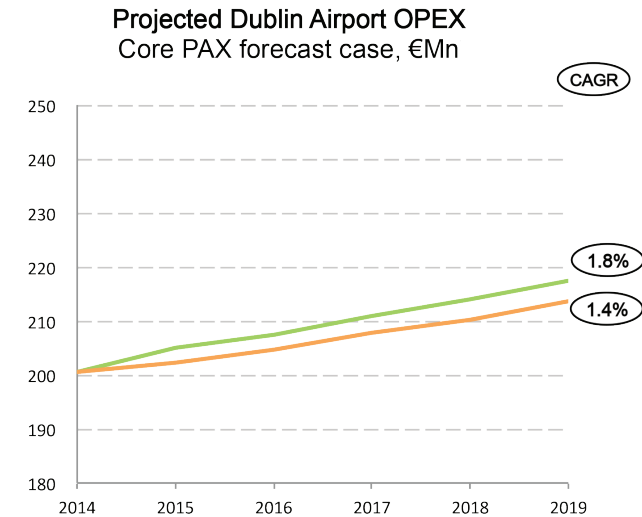
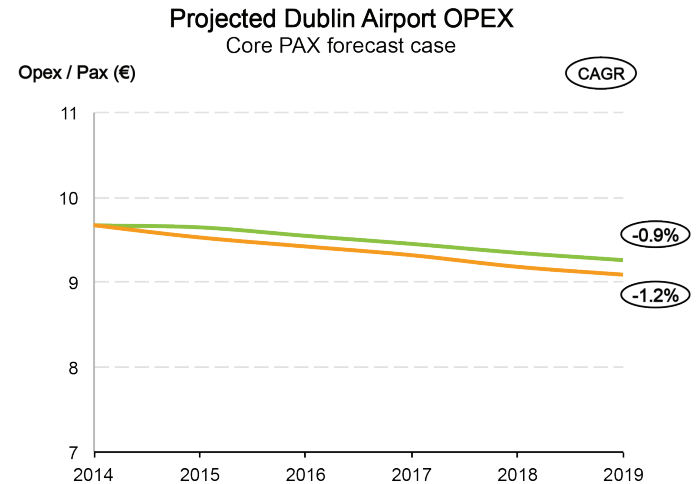


Figure 8: Projected OPEX/PAX 2014-2019 (real terms)



daa would support the extension of rolling incentives, as introduced by CAR in the 2009 Determination, into all areas of opex in which daa has control over the relevant cost. daa would see this as including all payroll costs, and all nonpay costs with the exception of rates, insurance,

CAR costs and Aviation Customer Support.

8. Commercial revenue – Subsidising airport charges at Dublin Airport

In 2013, Dublin Airport generated €128m⁵ in non-aeronautical gross margin. This income was generated through commercial activities comprising Direct Retail, Concession Retail, Car Parking, Commercial Concessions, Commercial Property Rental, Advertising and Other Commercial Activities. This €128m would equate to a net subsidy (after related operating expenses) of €80m to airport charges. Over the period 2010-2013 this subsidy will have totalled circa €315m. daa is forecasting to increase commercial revenue from €128m in 2013 to €138m in 2019 in real terms, i.e. an increase of 8% in real terms over the coming regulatory period.

8.1 Review of outturn 2010-2014 versus regulatory forecast

Excluding items which are treated as outside the Single Till⁶, total commercial revenue at Dublin Airport grew from €110m in 2010 to €128m in 2013. The cumulative total for the period was €472m, comparing with a CAR cumulative forecast of €492m – a difference of €20m. As Table 2 indicates, across the period, this difference was due to the over-forecast of passengers in the regulatory determination. Focussing on revenue per passenger, daa has outperformed the regulatory forecast in all but the first year of the determination period. However, this latter measure cannot be used without qualification, since different elements of commercial revenue are linked to pax numbers in different ways, with very little linkage in some cases.

Table 2: Commercial Income Outturn 2010-2014 vs. CAR Forecast

Commercial Income	2010 Actual	2011 Actual	2012 Actual	2013 Provisional
Forecast commercial income per CAR determination	119.6	121.5	123.8	127.1
Forecast pax (m) per CAR determination	19.5	19.9	20.5	21.3
Forecast revenue per pax	6.13	6.10	6.04	5.97
Actual performance				
Commercial Income	110.4	115.3	119.1	128.0
Difference versus CAR forecast	-9.2	-6.2	-4.6	0.9
% Difference	-7.7%	-5.1%	-3.7%	0.7%
Actual revenue per pax	5.99	6.15	6.24	6.35
Difference versus CAR Forecast	-0.14	0.05	0.20	0.38
% Difference	-2.3%	0.8%	3.3%	6.4%

8.2 Commercial revenue – Strategic business development

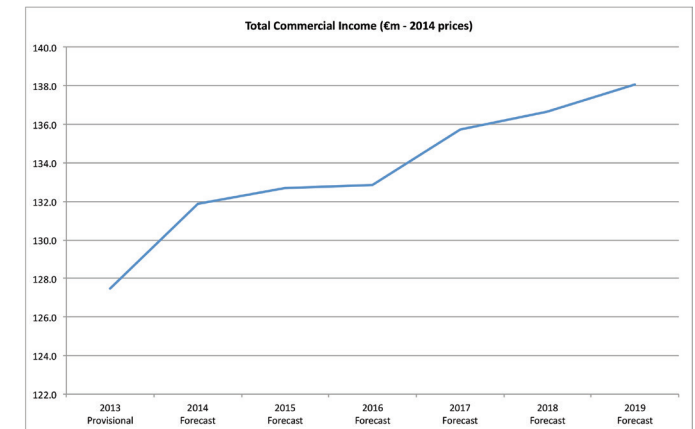
On-going management and development by daa of its commercial businesses is necessary to maintain existing income levels and achieve growth. Future revenue streams are reliant on continued engagement with changing customer needs and preferences, timely investment, and an on-going commitment to innovation.

daa has taken a detailed bottom-up approach to forecasting commercial income for the upcoming regulatory period. daa has used 2013 outturns as the baseline and forecast forward across the period by reference to appropriate determining factors. These include – as mentioned – our investment and business development plans, pas-

senger numbers, economic growth and inflation, competitive market developments and the regulatory environment (for example with regard to tobacco retail and purchase). While a top-down approach (incorporating elasticities) can provide a useful sense check, such an approach cannot adequately substitute for the detailed market and business analysis on which the daa forecast is based. In particular, revenue per pax would be an output from our forecasts rather than a starting basis.

Figure 9 shows our commercial income forecast over the period. daa is optimistic about the long term growth in commercial incomes and their role in supporting the operation and financing of Dublin Airport. At an overall level, commercial incomes are projected to increase from €128m in 2013 to €138m in 2019 in real terms (2014 prices). This represents an increase of 8% in real terms over the period.

Figure 9: Forecast Commercial Income 2015-2019



daa believes that the rationale for including rolling incentives in operating expenses also applies to commercial revenues and would welcome the expansion of rolling incentives into areas of commercial revenues in which daa has full control over the level of income and where the impact of passenger variances are excluded.

⁵ This figure of €128m is not directly comparable with the €127m figure for 2012 in the Regulated Entity Accounts see table 1. The commercial income forecast presented herewith excludes hangar income, income from the former Clarion Hotel site and property rental income that daa proposes to bring forward for exclusion from the till.

⁶ Pursuant to the 2009 Determination, CAR disallowed a capex project for hangar maintenance and to counter this commercial revenue was revised downwards by the expected uplift from the disallowed project.



9. Capital remuneration

9.1 Opening RAB 2015 2010-2014 Reconciliation

daa's last Capital Investment Programme was submitted in 2009 and contained planned investments for 2010-2014. Given the economic circumstances pertaining at the time of submission the programme focused on the spend necessary in the short term to replace and upgrade life-expired assets and to maintain customer service levels. Forecast spend by project group over the period 2010-2014 versus the CAR allowance is set out in the table below. (With regard to trigger projects, the larger of these have remained untriggered – Northern Runway 10/28 and associated projects, apron development, engine testing facility, new pier design fees. One such project was triggered – the Hold Baggage Screening (HBS) upgrade for T1, which was necessitated by European security legislation.)

Table 3: Forecast Outturn CIP 2010-2014 vs. CAR Allowance

Project Group	CAR Allowance (€m)*	Forecast Spend at end 2014 (€m)
Stands & Airfield**	32.4	33.1
Piers & Terminals**	7.6	30.7
Airport Operations	42.5	44.4
Landside Infrastructure**	22.2	14.0
Plant & Equipment	3.2	0.5
Utilities	37.0	9.2
Retail	10.6	11.0
Revenue	13.9	8.2
Programme Management & Contingency	19.4	20.3
Total Non-Trigger Projects	188.8	171.4
Trigger Projects	320.5	10.9
Total Trigger & Non-Trigger Projects	509.3	182.3

*No adjustment for inflation

**CAR allowance excludes projects consulted on separately by daa post the 2009 Determination through 'interim capex consultations'

As is clear from the table above, in some cases spend is greater, and in other cases lower, than the allowance for the project group in question. Where the spend was greater this was typically due to capital maintenance type activities. However, overall daa has underspent relative to the CAR allowance, and this reflects daa's economical approach to capital investment over the period. Variation at the project and project group levels reflects the reality that individual capital expenditure requirements cannot be forecast perfectly years in advance. Taking the example of the forthcoming regulatory determination period, in 2013 we were formulating plans for consultation with airlines in 2014, for spend over the period 2015-2019, i.e. planning up to 6 years in advance. daa will be recommending that a pragmatic approach is taken by CAR to the reconciliation of the 2010-2014 spend, and that further

steps will be made for the next determination to provide additional flexibility for daa to manage and develop the airport in a responsive, enterprising and forward-looking manner, with relative certainty with regard to the remuneration of capital, and without unrealistic reliance on unanimous support from current airport users for individual projects that arise between determinations. Such flexibility should be intended to lead not to increased spend, but to more efficient spend. daa's specific proposals with regard to capex flexibility are detailed in the CIP Proposals 2015-2019.

Other key decisions to be made by CAR with regard to the opening RAB for 2015 include (i) the final reconciliation of T2 and T2 Associated projects and (ii) the treatment of the T1X investment, which was dealt with only provisionally at the last determination.

T2 Reconciliation

- The original cost estimate for T2 produced by Davis Langdon PKS⁷ was €609m in 2006 prices (Cost Plan No. 1). The daa 'control budget' for the project was





€690m in nominal prices. This represented the €609m figure inflated using an assumption of 5% per annum construction-sector inflation together with the expected time profile of the expenditure (also factoring in delay relating to a planning permission challenge). The T2 outturn cost in nominal terms was €745m, i.e. an additional spend of €55m relative to the daa control budget.

- The CAR allowance expressed in 2006 prices was €582m. In arriving at this figure, CAR started from the €609m figure and deducted €27m, of which €25m was within the contingency amount specified in Cost Plan No. 1.
- In its Issues Paper, CAR reported that T2 Main Projects and Associated projects exceeded the combined capital allowances by €152m, expressed in 2012 prices, using CPI as the deflator.
- daa has three main points with regard to T2 reconciliation: (i) that the original contingency disallowance by CAR was inappropriate; (ii) that the use of the CPI

deflator (rather than construction price inflation) as a means for defining additional spend is incorrect; (iii) that the actual additional spend (relative to daa's control budget) of €55m or 8% was not untypical for a capital project of this size, and that the outturn cost for the terminal represents good value for a job professionally completed within an accelerated timeline and with an exemplary safety record.

- daa contends that the full amount of the T2 capital spend should be admitted to the RAB.
- daa believes that CAR's principles for the admission into the RAB of additional capital spend are unduly restrictive and represent an outlier in terms of regulatory practice. Other regulated utilities generally do not face the exclusion of normal capital spend from the RAB.

T2 Associated Reconciliation

- In daa's original 2006 CIP submission, the overall value of the projects subsequently grouped together by CAR as 'T2 Associated' was €150m in 2006 prices. Leaving aside for the moment – for immediate simplicity – the important issues with regard to the appropriate deflator to use (as discussed above), the outturn expenditure on the T2 Associated projects was €156m in 2006 prices, using CPI as the deflator. Within this overall outturn, there are numerous individual project variations.

T1X Reconciliation

- At the time of the last Determination, the airlines opposed the inclusion of the €55.5m investment for T1X in the RAB. CAR's compromise and provisional solution was to include the investment in the RAB on the basis that it would not affect airport charges. At the time, the econometric estimate of the incremental margin from T1X was approximately €5m. CAR set the capital remuneration of the asset at the same value of €5m (consisting of the 7% allowed return and a resid-

ual depreciation figure to bring the total to €5m).

- CAR indicated that this treatment would be revisited in 2014. The only way in which the current treatment could be continued would be if it were possible meaningfully to model the on-going incremental contribution of the T1X area to retail revenues. daa does not believe that this is possible. T1X is now an integral part of the overall retail offering in T1 and indeed of terminal accommodation. The reconfiguration of the T1X use profile in the current T1 retail revamp (an investment now underway as part of the retail capex allowance in the current determination period) will reflect this fact and heighten it.
- daa's recommendation is that the undepreciated portion of the T1X asset be added in full to the RAB value and remunerated in the standard way.

9.2 T2 remuneration profile

The capital remuneration treatment of T2 has a number of unusual features. Firstly, CAR took the view at the time of the 2007 Interim Review Decision that daa's specification of the terminal was too large. This is quite a complex issue, which we seek here to summarise in simplified form:

- In the course of the regulatory approval process for T2, daa indicated to CAR that the terminal was designed to accommodate 11.5mppa.
- CAR accepted that 11.5mppa was an appropriate handling capacity for the terminal. Based on CAR's view that the capacity of T1 was 18.5mppa, this would give total terminal capacity of 30mppa. However, in CAR's view the specified size of T2 was excessive to accommodate 11.5mppa.
- The basis on which CAR analysed the appropriateness of the size was to estimate peak hour use associated with 11.5mppa, multiplied up to create a full terminal size, based on standard industry ratios per passenger at specified levels of service. In order to allow

⁷ Davis Langdon PKS now Aecom was daa's appointed cost manager for the project.

some margin for error in this calculation, CAR's appointed consultants worked from a starting range of 11.5mppa to 13mppa, and estimated associated peak hour use of 2,900 to 3,300. They took the midpoint of the latter range, and multiplying up by the standard ratio produced an overall terminal size that was approximately 73% of the T2 specified size. On this basis, CAR allowed 73% of the relevant portion of T2 cost as Box 1, with Box 2 to remain unremunerated until the given pax threshold would be met.

- On the basis of the above logic, CAR set the trigger for releasing Box 2 at 30m in the Draft 2007 Interim Review Decision. However, in the Final 2007 Interim Review Decision, it increased the trigger to 33m, based on arguments that the capacity of T1 could be higher than 18.5m.
- At the time of the 2007 Interim Review Decision, actual peak-hour demand for T2 and the actual relationship between peak hour demand and annual passenger throughput were necessarily unknown and were a matter of disagreement as between CAR and daa. Looking at the actual data since the opening of T2, it is clear that using CAR's preferred sizing methodology with actual outturn throughputs (for (i) peak hour and (ii) aggregate annual outturn) indicates that T2 is not over-sized for circa 11.5m passengers.
- In light of the above, there is no justification for the continued deferment of Box 2 remuneration.

The second unusual feature of T2 remuneration is the unitised approach, which seeks to equalise remuneration not over time (as would be the case with an annuitised approach), but by passenger, based on an assumed passenger forecast over the life of the asset. Put simply, this approach massively backloads the return, which is sharply in contrast for example, with the more orthodox remuneration allowed for T5 in Heathrow.

Notionally, the regulated entity is indifferent to unitisation because the NPV for the streams of remuneration under

the different depreciation scenarios is identical. However, the regulated entity is not indifferent, because its immediate return is suppressed and because the future is inherently uncertain. Regulatory variables and regimes change. Economic circumstances are subject to dramatic cyclical and structural variations. Moreover, the regulated entity's actual discount rate for its own decision-making varies from the discount rate allowed by the regulator. In summary, unitisation is an unorthodox device to delay remuneration for a large piece of infrastructure. Not only is remuneration delayed, but the profile of remuneration remains uncertain (linked as it is with long-term passenger forecasts – deeply problematical in themselves). It is also not certain that the higher level of charges necessary in future years (to achieve the allowed return overall) would be commercially viable, which would mean that the revenue postponement would not be NPV neutral. Furthermore, even within CAR's own framework, unitisation has given rise to logical inconsistencies, for example (i) in the 2009 Determination CAR was forced to make a financeability adjustment whereby it accelerated depreciation on another specific project and (ii) the 25m passenger remuneration range for Box 1 (18m passengers to 43m passengers) is inconsistent with the Box 2 trigger of 33m passengers.

The implications of this approach are discussed more generally below under the heading 'Constrained Return on RAB'. daa welcomes CAR's openness, signalled in its Issues Paper of July 2013, to re-examining the remuneration policy for RAB assets, and daa calls for the unitised approach to T2 capital remuneration to be reviewed by CAR from first principles.

9.3 Weighted Average Cost of Capital (WACC) for Dublin Airport

daa commissioned NERA to provide an independent estimate of the weighted average cost of capital (WACC) for Dublin Airport for inclusion as part of the Regulatory Proposition.

In summary, the NERA analysis indicates that the real pre-

tax WACC for Dublin Airport should be set at between 7.64% and 7.81%, i.e. higher than the current allowed WACC of 7%. The increased range recommended by NERA reflects in particular: (i) the inclusion of a Country Risk Premium to account for the premium investors must receive to invest in Ireland; (ii) NERA's estimates of the beta for Dublin Airport, which is based on a relative risk assessment of comparator airports and change in risk since the last determination; (iii) NERA's estimate of the cost of debt, based on daa's actual borrowings (embedded debt) and the cost of new debt based on current forward curves.

NERA's findings are summarised in the table below. Overall, NERA recommends a real pre-tax WACC towards the top end of the estimated range given that there is little evidence of any substantial change to daa's relative risk since the last review.

Table 4: Dublin Airport Cost of Capital: Estimates

Project Group	Estimate (%)
Gearing	30 - 40
Real Pre-Tax Cost of Debt	3.09
Real Post-Tax Cost of Equity	8.8 – 9.6
Tax Rate	12.5
Pre-tax WACC	7.64 – 7.81
Vanilla WACC (Pre-tax debt, Post-tax equity)	6.82 – 6.98
Post-tax WACC	6.69 – 6.83

Source: NERA analysis.

10 Capital Development Proposals 2015-2019

10.1 Systematic approach to formulation of capital investment proposals

daa has undertaken a systematic approach to the identification of investment needs at Dublin Airport for the period 2015 to 2019 through:

- Systemised risk-based prioritisation of capital maintenance requirements consistent with ISO 55000 Asset Management standard;
- Review of regulatory requirements (e.g. with regard to security, environmental impacts etc.);
- Review of Dublin Airport capacity pipelines on a processor by processor basis, identifying capacity bottlenecks which will impede growth and proposing dynamically efficient solutions to the bottlenecks in question, based on expert independent advice;
- Where appropriate, putting forward capacity projects as trigger projects, contingent on specific circumstances, including demand and regulatory conditions;
- Identification of commercial revenue projects to maintain and grow commercial revenues leading to increased subsidy of airport charges through the Single Till mechanism;
- Early identification of airline needs (before drawing up our capex proposals) through three consultation processes in 2013, one conducted by our independent design contractor Pascall & Watson, the others conducted directly by daa in conjunction with our volume-forecasting engagement and our annual airport charges consultation under the aegis of the European Airport Charges Directive;
- Following the collation of our capex proposals, a further comprehensive, detailed consultative engagement with airlines over a five-month period in total, in which daa explained and answered questions on its proposals on a project by project basis.

In line with the above, projects included in CIP Proposals 2015-2019 are proposed because they fulfil one or more of the following criteria:

1. Current assets require repair or replacement as per the 'Economic intervention' approach to asset management.
2. There is an absolute new requirement as current capacity is fully utilised or will be fully utilised (latter category may be subject to investment trigger).
3. A safety or regulatory requirement is driving the investment (may be subject to investment trigger).
4. A commercial opportunity exists which will generate a positive NPV in maintaining or providing additional subsidy to the single till.
5. The project reflects a specific request by one or more airlines.

The proposals themselves are set out in detail in the CIP Proposals 2015-2019. For the purposes of this summary, we confine ourselves to listing the proposals by tranche and project grouping, and outlining the total price cap impact.

10.2 Overview of CIP Proposals 2015-2019

CIP Proposals 2015-2019 contains three tranches of capital investment:

- Tranche 1 represents 'Capital Maintenance', i.e. the investment needed to to maintain existing assets efficiently. This spend will allow the continuation of facilities and level of service to match the existing level of traffic at the airport. The total proposed investment under this tranche is €186m.
- Tranche 2 represents 'Business Development', including projects (i) to maintain existing commercial revenue streams, and (ii) to provide new assets, new efficiencies, and new revenue streams at the airport. Category (ii) of this spend will secure provision of the facilities and service level required to accommodate our Core traffic fore-

cast to 2019 and underpin operational efficiencies and increased commercial revenues, reducing pressure on airport charges. The total proposed investment under this tranche is 183m.

- Tranche 3 represents contingent projects. These include typical trigger projects such as T1 check-in and security, which is proposed with a volume trigger of 11.5m departing passengers in a 12 month period⁸ and Pier 2 segregation which stems from a compliance requirement. Other projects, such as the additional line-up points for 10-28, are contingent on business cases for the projects themselves, interacting for example with the existing trigger for Northern Runway 10-28. The total proposed investment under Tranche 3 is €86m.
- The final category of spend under CIP Proposals 2015-2019 is 'Other'. This includes house-keeping spend associated with the CIP, namely a 'minor works' allowance of €10m (€2m per annum), €3.5m in programme management cost, and €8.5m in preparatory investment for the Northern Runway, including house buy-out funds and planning and associated fees. The total proposed investment under the 'Other' heading is €22m.
- In the last determination CAR set the trigger for the Northern 10-28 runway ('Northern Runway') at 23.5m pax in a rolling 12 month period. daa recommends that this trigger remains in place for the forthcoming determination period. This trigger allows for a three-year construction/commissioning timeline. (The Northern Runway trigger is discussed in full detail in CIP Proposals 2015-2019).

⁸ This trigger is predicated on the security queue target remaining as 'security queue less than 30 minutes 100% of the time'. In the event of a more demanding security target, the attendant capacity implications may require an earlier trigger for the redevelopment of T1 security.

Table 5: Summary of Capital Investment Programme 2015-2019 Proposals⁹

Tranche 1: Capital Maintenance			€m*
Apron and airside roads	80	Runway overlay, apron rehabilitation, airside roads	
Airfield pollution control	20	Storage tanks for contaminated run-off and used glycol	
Airfield - Other	21	Lighting upgrade to 10-28 and taxiways, Heavy and light vehicles	
Terminal/landside infrastructure	33	T1 roofing, BRS, Baggage PLC, LSS, lift replacement, HVAC & BMS, car park equipment, road resurfacing, utilities	
IT lifecycle management and systems investment	31		
Sub-total	186		

Terminal - Customer/efficiency improvements	12	T1 façade, Arrivals, Pier 1 gate rooms, FEGP
Commercial investment	32	T2 MSCP, car rental centre, long-term car-park resurfacing, hangar infrastructure, staff car-parking etc.
IT innovation & Retail IT	10	
Cargo and screening	5	Third party staff screening, cargo screening, cargo terminal development
Sub-total	183	

Tranche 3: Contingent Projects - Expected			€m*
Parallel feeds to Runway 10-28	30		
Pier 2 segregation	18		
T1 check in and security	38		
Sub-total	86		

Other:			€m*
Sub-total	22	North runway studies, planning and preparation, programme management, minor works	

Total:			€m*
Tranches 1- 3 + Other	477		

There are a number of additional projects where triggers are proposed where expenditure is not envisaged in the

2015-2019 and details are set out in the table below.

Table 6: Contingent Projects - Not Expected

Project Type	Value (€m)	Trigger Proposed	Inclusion in CIP Proposals 2015-2019
Fuel Farm	25 ¹⁰	Occurrence of a technical, legal or commercial impediment to the tendering process to appoint a DFBOT operator for the fuel farm, of such significance that no operator can be appointed.	Not expected to trigger
Runway 10-28 Extension	55	Project allowed if trigger for Northern Runway set > 23.5m passengers in a 12 month period	Not expected to trigger; Not the preferred development option
Runway 10-28 Extension and Addition of Line-up Points ¹¹	74	Project allowed if trigger for Northern Runway set > 23.5m passengers in a 12 month period	Not expected to trigger; In the event of Northern Runway trigger of > 23.5m, this project represents an efficient development option
Northern Runway	245	23.5m passengers in a 12 month period	Trigger event expected circa 2019 with release of capex allowance in the following year

*Note that the figures in this and subsequent tables are subject to rounding.

Tranche 2: Business Development			€m*
Commercial and retail property maintenance	23	Retail and office accommodation refurbishments	
Terminal capacity works	74	Bus lounges, T2 transfers, Pier 3 Code F flexibility, Central search new technologies, HBS Standard 3	
Apron capacity works	28	5G, 300R and Code F flexibility for Pier 3	

⁹ Capex amounts do not include capitalised labour.

¹⁰ €25m is the cost of providing 3 x 5 million litre tanks, with an airside into-plane unit and connection of the fuel hydrant system on Pier 4. Additional costs would be incurred to provide fuel hydrant systems on Piers 1-3, as appropriate.

10.3 Impact of capital investment proposals on price cap

Table 7 sets out the impact of daa capex proposals on the price cap. (The notional stand-alone impact of individual projects is set out in the full CIP Proposals 2015-2019 document.) A number of contextual points should be made:

The price cap is a complex mechanism. Its level in any given year is affected by numerous factors, including: (i) the forecast opex and commercial revenue for the year; (ii) the forecast passengers for the year; (iii) the average value of the RAB for the year in question; (iv) the depreciation/remuneration treatment of the different components of the RAB (there are currently five different types of treatment of RAB value); (v) the allowed WACC; (vi) the rate of inflation; (vii) other factors, including service performance versus target, previous under-recovery, CAR's levy, smoothing effects.

- Changes in the price-cap level from one year to the next reflect multiple movements in the above values.
- With regard specifically to the impact of a proposed capital programme on the price cap, the value is added gradually over the course of the determination period, with typically one fifth of the total value added to the RAB each year over the five year period, and with trigger capex added only if and when the triggers are reached. While capex is added to the RAB over the determination period, existing capital value is also exiting the RAB each year as assets reach full depreciation.

For key categories of daa's proposed CIP, the table shows the average annual price cap impact in real terms over the course of the 5-year period. Taking account of the impact of capital value exiting the RAB, the net impact is 72c.

Table 7: Average Annual Price Cap Impact

Average annual price cap impact (real terms relative to 2014 price cap)	
Tranche 1: Capital maintenance investment (€186m)	69c
Tranche 2: Business development capex (€183m)	68c
Tranche 3: Contingent Projects – Expected (€86m)	21c
Other (€22m)	12c
Impact of capital value exiting RAB	-97c
Net price cap impact of daa capital investment proposals	72c

11. Financeability

In making a determination, CAR is statutorily obliged 'to enable Dublin Airport Authority to operate and develop Dublin Airport in a sustainable and financially viable manner.' Financial viability relates to the immediate and long-term sustainability of trading and financial positions. This encompasses a range of issues. The most pressing issue informing our comments here is daa's requirement to refinance €700m of maturing debt facilities over the course of the forthcoming determination period, consisting of a €150m revolving bank credit facility expiring in December 2016 and a €550m Eurobond which must be repaid in July 2018. This is a significant amount to refinance in the context of daa's size, the concentration of its operations in one of Europe's peripheral economies and the weak conditions (from a seller's perspective) in the market for debt of this type.

In 2008, daa completed a substantial debt raising programme in order to fund its investment plan. Since that time daa has been exposed to significant financing risks caused by a combination of credit and market factors as set out below:

- Irish sovereign was downgraded from AAA to BBB+/
BB+ equivalent by credit rating agencies;

- Risk profile of T2 development and uncertain cost recovery;
- Substantial unexpected reduction in traffic during the recession resulting in lower revenues;
- Downgrade of daa's own credit rating by Standard and Poor's from A (stable) to BBB with a threat, at one point, of a further 2 notch downgrade to sub-investment grade status;
- Shutdown of the international debt markets to 'pure' Irish issuers from 2009 to early 2012;
- Embargo by international banks on lending to Ireland and active reduction of Irish credit exposure.

While daa experienced a 'near miss' of a downgrade to sub-investment-grade status we were able to withstand the above shocks and the financing risks principally through a strategy of:

- Firstly, having pre-funded its debt requirements through a €600m bond issue in 2008, before the recession and the financial crisis hit, when daa was still rated A with the support of ownership by the AAA rated Irish sovereign;
- Secondly, through raising additional funding with the European Investment Bank and
- Thirdly, through proactive containment of costs and positive ARI cash flows to mitigate the impact of lower traffic on profitability¹². In this regard, the group's unregulated business has supported the regulated business through shoring up daa's credit metrics.

The only market financing undertaken by daa involved the refinancing of a revolving credit bank facility in 2011 resulting in raising €150m from local lenders.

In the view of daa's financial advisors, debt market conditions will remain challenging for daa in the next regulatory

¹¹ Additional line-up points for Runway 10/28 is a stand-alone trigger project within the 'Contingent – Expected' total in Table 6 above, i.e. comprising €30m of the €86m. Their inclusion in 'Contingent - Not Expected' projects is due to the fact that there is an economy of circa €10m from undertaking this project in conjunction with the runway extension, if the latter is the selected development option.

¹² A portion of these positive cash flows related to once-off cash flows. With regard to the on-going trading of ARI, the repositioning of the business, including strategic exit from the CIS market, means that daa group will not be able to rely on comparable levels of subvention in the future.

ry period. The following are the key points in this regard:

- Irish sovereign risk is still a real risk for investors and investors require a sovereign risk premium that reflects the lower Irish country credit rating;
- daa has limited choice of funding options and access to the bond market is critical;
- BBB+ rating is essential for daa to refinance its maturing debt facilities on optimal terms;
- daa must target minimum ratios of FFO:Debt \geq 23% and Debt:EBITDA \leq 3 (this was 3.7 for daa in 2013) for a BBB+ credit rating;
- At a low investment grade rating, the risk of being shut out of the markets remains material;
- If daa found the debt markets closed to it, this in turn would require that the shareholder, the Irish Government, inject equity into the business to support the continued operation of the airport. Such shareholder support could not be relied upon and in any event would likely be in contravention of recently issued state aid guidelines for airports, particularly if it was



necessitated by poor financial returns within the business;

- If a low investment-grade rating did not lead to exclusion from the markets, it could significantly raise the cost of debt, including imposition of conditions.

We conclude in this section on a point of fundamental importance; which is that CAR has previously relied on the credit rating of daa group as a whole as a key assessment of whether it has met its responsibility with regard to financial viability. This, in practice, allows the regulated entity to free-ride on the financial performance of the group. For instance, as recorded in the published audited regulatory accounts for 2012, the FFO: Net Debt ratio for the regulated entity was $<10\%$, while the same ratio for the group for 2012 was circa 19%. An FFO: Net Debt ratio for the regulated entity of $<10\%$ could not support the investment grade rating necessary for the regulated entity to raise debt and refinance on an efficient on-going basis. This approach on the part of CAR is inconsistent with utility regulation in Ireland, which does not take into account the group metrics but rather the target regulated asset metrics for assessing financeability.

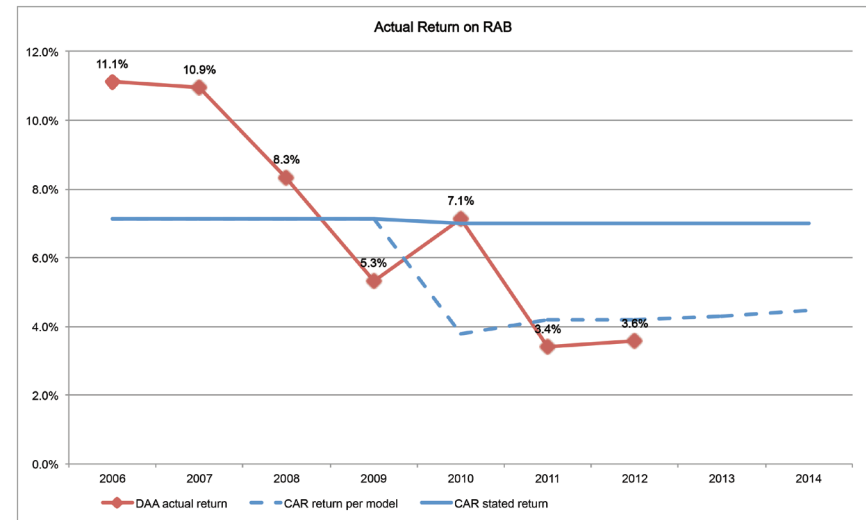
Under CAR's current approach if daa group excluding Dublin Airport was losing money, it would be consistent for CAR to allow Dublin Airport to earn a return exceeding its WACC in order to ensure the financeability of the daa group. In fact the proper methodology would ensure that in situations where daa group made a loss the regulated asset WACC would not subsidise non-regulated assets for financeability. daa hereby calls on CAR to assume responsibility for ensuring the financeability not of daa but of the regulated entity for which it has the responsibility of economic

regulation.

12. Constrained Return on RAB

There is no guaranteed return in incentive regulation, but generally speaking it is achievable for the regulated entity to make or exceed its allowed return if it meets its efficiency, revenue and service quality targets. By contrast, in the case of the regulatory regime which daa faces, even if daa exactly achieved all targets/forecasts with regard to expenditure, revenue, service quality and capex projections etc., there remains in the price-control a structural impediment to the achievement of the full allowed return within the year or indeed across the full regulatory period: namely the capital remuneration treatment of T2. The impact of this treatment can be seen in the graph below, with historical figures taken from the published, audited regulatory accounts and provisional/forecast figures for 2013 and 2014.

Figure 10: Actual Return on RAB 2006-2014



The need for regulation is predicated on the existence of market power. However, the process should also be frank about the considerable countervailing buyer power which daa faces through having two powerful custom-



ers, accounting currently for > 80% of daa's business. The regulatory process should proceed with an awareness of the risk that regulatory outcomes may be overly dominated by the interests of these companies, which in turnover terms and in communications presence are bigger or far bigger than daa. The capital remuneration of T2 is a case in point, currently offering a return structure that no competitive-market firm or privately-owned regulated utility would find acceptable. Why did daa build T2 under those conditions? Because the existing facilities were completely congested; because it was a matter of national importance that increased terminal and pier capacity be delivered at Dublin Airport. These needs were acknowledged by the Government resulting in the Ministerial Directive to provide a second terminal facility. As it transpired, volumes fell dramatically before T2 was ultimately delivered, but this could not have been known at the time.

In summary, an important question arises: whether regulatory settlements under the existing regime reflect an appropriate protection for the market **or** give rise to sub-normal return for Dublin Airport.

daa welcomes CAR's openness, signalled in its Issues Paper of July 2013, to re-examining the remuneration policy

for RAB assets, and daa calls for the unitised approach to T2 capital remuneration to be reviewed by CAR from first principles.

13. daa's pricing proposals 2015-2019

Dublin accounted for 64% of international air travel to/from the island of Ireland in 2013. This is clearly a strong market position, and demonstrates that Dublin is the only airport on the island with the scale to function as a hub. Nevertheless, Dublin has competitors, i.e. other airports on the island accounting for 36% of the market. Dublin also competes with airports in other countries in attracting airline capacity, in terms of routes and schedules. Through the mobility of their assets, airlines exert considerable competitive pressure on airports. As indicated earlier in this document, capacity shifts by airlines in recent years at Dublin Airport have been dramatic – with Ryanair demonstrating a 30% swing from peak capacity in 2008, Aer Lingus demonstrating a 17% swing, and other airlines – in total – demonstrating a massive 44% swing from peak to low-point capacity. Dublin also faces considerable market pressure through having over 80% of its traffic concentrated in the two main carriers, Aer Lingus and Ryanair, who, individually and collectively, exert considerable countervailing buyer power, in their direct engagements with daa, but also through the mechanism of the regulatory regime.

The hypothesis that can be drawn from the above is that Dublin Airport does not have monopoly power to price. And in reality, Dublin Airport **has** chosen in specific years not to price to the current low price cap, precisely for reasons relating to the potential impact on the market. See table 8.

Table 8: Dublin Airport Pricing

Dublin Airport pricing versus cap, 2011-2014				
	2011	2012	2013	2014
Price cap	10.42	10.74	10.65	10.68
Charged price	10.35	10.45	10.56	10.55
Difference	0.07	0.29	0.06	0.13
% increase on previous year		1.0%	1.3%	-0.4%
CPI		1.7%	0.5%	1.5%

Notes: 2014 'Charged price' is an initial estimate. Precise outturn will vary depending on load factors etc. CPI 2014 figure is from ESRI 2013 Autumn Review. Early 2014 inflation results are lower.

Airport charges at Dublin Airport have fallen in real terms over the last four years. daa's pricing adjustments have been minimal. Generally speaking, prices have been left flat, so that changes in the average nominal outturn price reflect impacts such as full-year effects of previous pricing, unwinding of discounts etc. In the annual pricing consultation for 2014, the only change made was to reduce the PRM-levy by 6c per departing passenger, delivering on a commitment that daa had made that the PRM service would be run on a cost-recovery basis and that any cost savings would be priced through to customers.

The conclusion that daa would make from the above is that the price and the price-cap are not synonymous. However, even though daa has priced below the cap – because of its keen awareness of the demands of the market and the risk that price increases would impede growth – we would nevertheless argue that the price cap itself was erroneously low. In daa's view, the focus of the regulator should not be to attempt to set the market price, but – as per the legislation – to set the **maximum** price, which can be viewed as a protection from the possibility of monopoly outcomes. daa believes



that if the price-cap is calculated in a fair and systematic way, using an evidence-based approach to the determination of each building block, this will generate an appropriate price-cap, which in the present circumstances will be considerably above the prevailing market price.

This Regulatory Proposition contains recommendations with regard to each of the price-cap building blocks: pax forecast; efficient operating cost; commercial revenue; opening RAB value; depreciation treatment of different assets; WACC; CIP Proposals 2015-2019; customer service proposition. It will be a matter for CAR to rule on the different variables within each building block and to calculate the overall price-cap. In daa's calculation, on the basis of our evidence based recommendations for the building block values, the outturn price-cap (averaged over the 5-year period) would be slightly below €13.50 per passenger (real terms). daa would regard this as the appropriate level for the price-cap. A price cap of this order will also generate appropriate financeability metrics for Dublin Airport, of the level that will support the refinancing of debt associated with the airport over the course of the period, without the requirement that the financeability of Dublin Airport (the regulated entity) be

carried by the daa group.

Submitting for a price-cap in the region of €13.50 is not synonymous with proposing that prices will rise to that level. Passenger traffic at Dublin Airport is still recovering from the economic crash. daa believes that the positive growth of recent years can be maintained, but that this will require support from daa through lower charges than would be generated if pricing fully to a fair, evidence-based price cap.

In the short to medium term, in the context of a market where it faces considerable countervailing buyer power (including one major customer with a high number of bases throughout Europe and a demonstrated history of shifting capacity), daa proposes to make a strategic investment in the market through pricing below a fair cap. Working off our Core forecast, daa envisages pricing remaining broadly at current levels in real terms. daa believes it is possible to price in this way and deliver the capital development programme herewith submitted. In fact, the capital development programme is necessary to create the capacity to accommodate future growth.

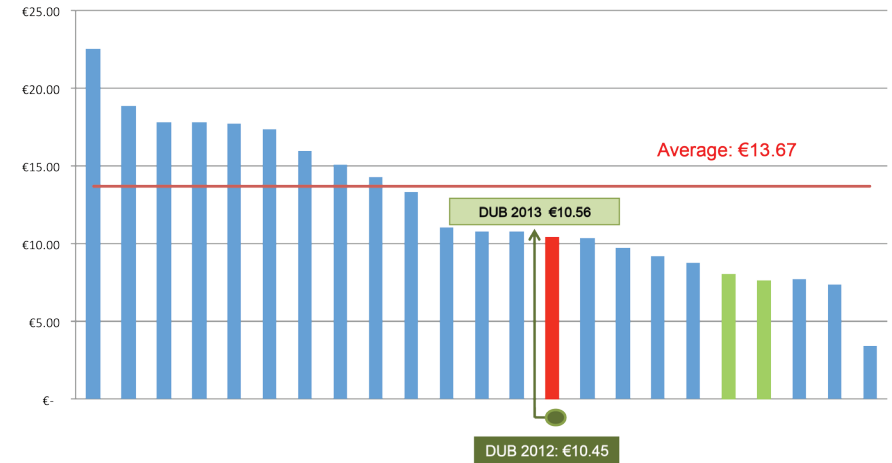
daa believes that further growth may be stimulated by additional highly-targeted volume-related discounting (focussing on incremental passengers above pre-defined thresholds), and we would expect to be consulting early with our airline customers in this regard, subject to the content of CAR's Determination.

Charges at Dublin Airport remain highly competitive, as Figure 11 indicates. Note that a price-cap slightly less than €13.50 would still be below the observed average price in the relevant market segment in 2012.

Figure 11: Comparative Airport Pricing 2012

Dublin's Charges Remain Competitive

Aeronautical Revenue Per Passenger 2012



Source: Airports Council International (ACI) Key Performance Indicator Project

Individual airport charges cannot be shown for reasons of commercial sensitivity to the airports concerned. Other airports in the table are Athens, Stockholm Arlanda, Amsterdam Schiphol, Brussels, Copenhagen, Frankfurt, Oslo, Gatwick, Heathrow, Lisbon, Milan Malpensa, Munich, Stansted, Vienna, Zurich, Rome Airports, Istanbul Ataturk, Paris Airports, Barcelona, Madrid, Malaga, Palma Mallorca

*Airports in green are based on 2011 figures, as 2012 data not yet available

At the outset of the current domestic regime of economic regulation of airports, CAR set price caps for Shannon and Cork airports. This practice was later discontinued, once it was clear that the market required much lower prices and that the price caps would not be reached. In such circumstances, to discontinue the price cap, or to maintain it at the predefined level, is – in daa's view – the better regulatory approach than to attempt to engineer the price cap downwards, in order to bring it into line with the observed market price. It is not daa's suggestion that there be no price cap set for Dublin Airport for the period 2015-2019, or for periods thereafter, but rather that the setting of an appropriate price cap will provide an opportunity to demonstrate that market conditions will control the price. This was observed in the case of Stansted, where the market price has been systematically lower than the price-cap. It will be very much in daa's

interest to deliver on a pre-determination promise with regard to pricing, as this would support future arguments for an evolving approach to price cap regulation, for example in the direction of the regime envisaged under the European Airport Charges Directive.

14. Concluding comments

In producing this submission, we have endeavoured to follow transparent, consultative processes engaging our airline customers.

- In the case of traffic forecasting, we consulted with airlines on both forecasting methodology and outturns, and presented an Initial Range Forecast and other scenarios. The forecasts have now been refined and we present herewith our Revised Range Forecast.
- In the case of our capital investment proposals, we consulted with airlines in advance of formulating the proposals (through (i) the survey/interview process conducted by our appointed design team Pascall & Watson and (ii) our own 'requirements' consultation under the Airport Charges Directive), and later presented the proposals themselves in considerable detail in our capex consultation process, which commenced with the circulation of initial materials in December 2013 and involved over a dozen formal capex seminars, culminating with final comments from airlines in March 2014, with further process steps on IT capex and regulatory-till exit proposals running into April/May. While not generally recorded in their formal written comments, the feedback from airline participants with regard to the consultation process, as the process proceeded, was generally very positive.

In our approach with regard to service quality metrics, we have taken the view that it would be useful for the process of economic regulation of the airport to take an integrated, holistic view of service quality from the perspective of the passenger. This would mean tracking and publishing not only metrics reflecting daa performance, but also measurements of other processes central to the passengers' experience of

the airport, e.g. check-in, boarding, departure punctuality etc., for which other stakeholders have or share responsibility. While there was not evident support for this proposal from airlines during the course of the capex consultation, we nevertheless recommend this approach for further consideration to CAR. There is collective responsibility for passenger experience at the airport, and it would be helpful for this to be reflected in the quality results published by CAR.

We have not sought, in this submission, to repeat discussion that has already been covered in previous process steps. We have not referred to the issue of volume risk, which was covered in detail in our response of September 2013 to CAR's Issues Paper (CP2/2013). Nor – generally speaking – have we discussed approaches to regulation, which, again, were examined in our Issues Paper response. There is, however, one aspect of approach that we would reiterate here, namely passenger focus. daa believes that passenger welfare and preference should be given more emphasis in regulatory decision-making. Passengers have the classic characteristics

of a stakeholder group whose interests are likely to be neglected, namely they form a large, anonymous, heterogeneous, dispersed group, with no collective organisation or representation. Nevertheless, passengers are the ultimate consumer whose welfare is to be served by the outcomes which regulation targets. Passenger welfare is also a crucial factor in determining passenger spend, which in turn feeds the commercial revenue which subsidises airport charges.

