Draft Decision on the

Interim Review of the

2014 Determination of the

Maximum Level of Airport Charges at

Dublin Airport

Commission Paper 1/2017

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1. Executive Summary

1.1 This paper sets out our Draft Decision on the regulatory treatment of the North Runway at Dublin Airport. It follows our decision (CP2/2015) to conduct an Interim Review of the 2014 Determination to amend the North Runway trigger and our decision (CP6/2016) to limit the scope of the Interim Review to aligning the remuneration of the North Runway with the timeline of delivery and any enhanced reporting or monitoring that may be required.[1]

1.2 After reviewing the 2014 Determination, we propose to replace the existing trigger with three triggers which increase the price cap in three stages to remunerate the project. The draft triggers are shown in Table 1. The first adds €0.06 in the year that follows the start of construction of the main project. Once the North Runway is fully operational €0.50 will be added to the price cap. The remaining €0.03 will be added when all aspects of the project are complete including the house buy-out scheme. All amounts are added to the price cap in the year following the event. The draft triggers are outlined below and fully defined in Section 4.

Table 1: Draft Triggers and Construction Milestones of the North Runway

Milestone Number	Name	Proportion of Total Expenditure	Estimated Timeline by Dublin Airport	Estimated Capex	Draft Triggers
M1	Main Construction Start	10%	2017	€24.7m [2]	€0.06 on the year after M1.
M2	North Runway Fully Operational	85%	27 months after M1	€209.7m	€0.50 on the year after M2.
M3	House Buy-out Closure	5%	36 months after M2	€12.3m	€0.03 on the year after M3.
	TOTAL	**100%**		**€246.7m**	**€0.59**

1.3 Dublin Airport will not be allocated the volume risk on the triggers. When we reconcile the project, we will calculate the return on capital collected by the proposed triggers using outturn passenger numbers; and adjust the depreciation of the project according to the under/over collection of return on capital due to differing outturn passenger numbers. Depreciation of the project is projected to commence once the €0.50 increase in the price cap occurs.

1.4 This Draft Decision has due regard to our three statutory objectives. First, it will facilitate the efficient and economic development of Dublin Airport which meets the requirements of users by providing a strong incentive to Dublin Airport to deliver a fully operational North Runway in a timely manner and giving certainty of remuneration for the project to allow it to proceed. Second, it will protect the interest of current and future users by ensuring that, for the most part, users will only pay for the project when the benefits are available to be realised. Third, we show that the draft triggers enable Dublin Airport to have financial metrics sufficient to allow an investment grade rating (S&P BBB or greater). This was stress tested under a conservative growth scenario and two negative scenarios, stagnating and declining passenger traffic.

[1] http://www.aviationreg.ie/_fileupload/2015/review/2015-12-22%20Decision%20on%20Conducting%20Review.pdf
http://www.aviationreg.ie/_fileupload/2016/scope/2016-10-13%20Decision%20on%20the%20Scope%20of%20the%20Interim%20Review.pdf

[2] Unless otherwise stated, all costs and prices are reported in July 2014 prices using the Central Statistics Office's consumer price index (CPI) to convert nominal values into real values. This price level is used for consistency with the 2014 Determination.

1.5 In arriving at these proposed triggers for the North Runway, the Commission also had due regard to the statutory factors that apply, in particular, the level of investment in airport facilities, operational income, cost liabilities, quality of services and cost competitiveness of Dublin Airport that meet the needs and interests of current and prospective users.

1.6 This Draft Decision on the Interim Review of the 2014 Determination is subject to a public consultation. We invite interested parties to comment on it in accordance with Section 8 of this paper. We will assess all submissions received and a final decision will be published in April 2017.

2. Notice of Making a Determination

2.1 In accordance with Section 32 (7) of the 2001 Aviation Regulation Act, we hereby give notice of our intention to make an amendment to the 2014 Determination of the Maximum Level of Airport Charges at Dublin Airport.

2.2 Pursuant to the 2001 Act, we must allow a statutory consultation period of no less than one month from the date of publication of this notice. As in previous periods, we give notice by way of publishing this Draft Decision. The deadline for receipt of representations is **5pm, 3 March 2017**. Interested parties should note the contents of Section 8 concerning the deadline. The conditions contained therein will be strictly applied without exception. Interested parties should also note the guidelines regarding issues such as delivery of documents and confidentiality.

3. Background

Interim Review – North Runway Trigger

3.1 This paper sets out the Commission's Draft Decision on the Interim Review of the 2014 Determination with regards to the regulatory treatment of the North Runway at Dublin Airport.[3]

3.2 The Commission established the existence of substantial grounds for this Interim Review in CP2/2015.[4] In that Decision, we indicated that the North Runway trigger as set out in the 2014 Determination would allow full funding of the project for a significant period of time in advance of construction, thus compromising the objectives of the 2014 Determination to protect the reasonable interests of current and prospective users. The Commission estimates that the 2014 trigger would have resulted in users paying €16.5m in 2016 for the remuneration of the North Runway without having received any benefit. This Interim Review aims to preserve the objectives of the 2014 Determination.

3.3 Subsequently, we received requests to expand the scope of this Interim Review beyond the timing of remuneration of the North Runway to include the cost allowance, the 50/50 risk sharing mechanism for over or under-spends, the tendering process, capacity assessment and the length of the Runway. We consulted on those requests in CP4/2016 [5] but ultimately decided in CP6/2016 [6] to limit the scope of this Interim Review to the timing of the trigger for the remuneration of the North Runway and, if necessary for the operation of the trigger, milestone reporting and monitoring conditions.

3.4 In CP6/2016, we stated that the 50/50 risk sharing mechanism may not be appropriate if the final cost estimate is substantially different to the allowance. However, we noted that setting a new allowance at this time would be premature considering that the recent estimates suggested by Dublin Airport are still subject to change.

3.5 We also expressed in CP6/2016 that if at a time of greater certainty about the total project cost the 50/50 risk sharing mechanism is deemed to be inappropriate, principles similar to the RAB roll forward principles set out in Annex 3 of the 2009 Determination may be more appropriate. Section 6 explains how we could move away from the 50/50 risk sharing.

North Runway Trigger – 2014 Determination

3.6 The 2014 Determination set out a trigger to remunerate the North Runway. It allows remuneration of the capital costs of €247m by adding €0.59 to the price cap on the year following Dublin Airport serving 25 million passengers in a 12-month period.[7] At the time of making that Determination the Commission was of the understanding that Dublin Airport could commence construction of the North Runway in late 2016 as per its 2015-2019 Capital Investment Plan.

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[3] This project has been referred to as the North Runway in the 2009 Determination, Northern Runway in the 2015-2019 Dublin Airport CIP and the 2014 Determination, Northern Parallel Runway in the response by Dublin Airport to CP1/2015 and by the Commission in CP2/2015 and CP4/2016, and is referred back to North Runway since the response by Dublin Airport to CP4/2016 in August 2016.

[4] http://www.aviationreg.ie/_fileupload/2015/review/2015-12-22%20Decision%20on%20Conducting%20Review.pdf

[5] http://www.aviationreg.ie/_fileupload/2016runway/scope/CP42016%20Consultation%20on%20Expanding%20Scope.pdf

[6] http://www.aviationreg.ie/_fileupload/2016/scope/2016-10-13%20Decision%20on%20the%20Scope%20of%20the%20Interim%20Review.pdf

[7] http://www.aviationreg.ie/_fileupload/2014final/2014%20Final%20Determination.pdf

3.7 The 2014 trigger is silent on the question of prefunding. Dublin Airport could have commenced construction of the project prior to reaching 25m passengers. The 2014 trigger is not aligned to any expenditure or construction milestones. Table 3.1 shows the three projects that the 2014 Determination trigger remunerates:

Table 3.1: Projects Remunerated by the North Runway Trigger in the 2014 Determination

CIP Number	Project	CAR Allowance
15.6.018	Planning and Design Fees (Runway Related)	€4.0m
15.6.019	House Buy-out (Runway Related)	€4.3m
15.6.051	North Runway (3,110m in Length)	€238.4m
	Total Allowance	**€247m**

Table Source: CAR 2014 Determination and Dublin Airport's CIP 2015-2019.

Requirement to Review the 2014 Trigger

3.8 The expectation of the Commission when setting the 2014 trigger was that construction could commence in late 2016. However, when the 2014 trigger was set, no party anticipated that 25m passengers per year would be reached prior to 2020. The Commission forecasted traffic of 24.7m in 2019 while Dublin Airport estimated it would be 23.6m. Growth was much faster than expected, Dublin Airport served over 25m passengers in 2015 thus activating the 2014 trigger. Construction of the main project is expected to commence in Q2 2017.

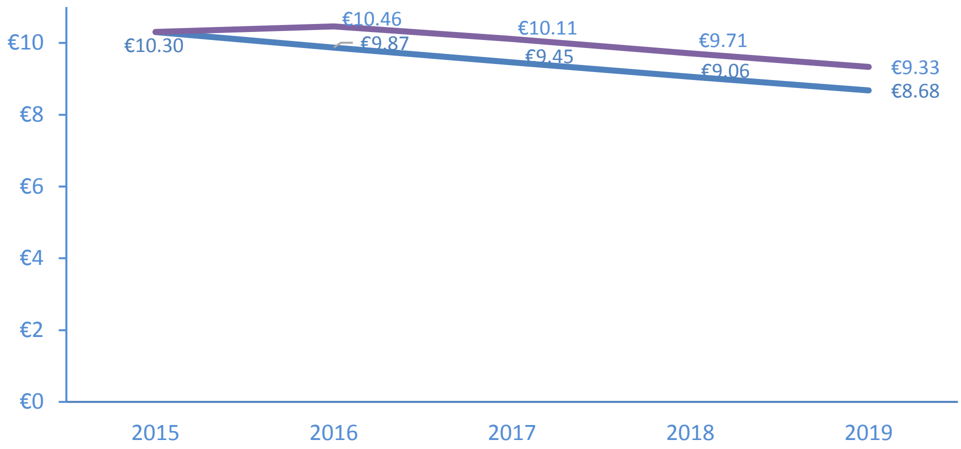
3.9 Following CP2/2015, which established the existence of substantial grounds for this Interim Review, this Draft Decision aims to preserve the original objectives of the 2014 Determination to protect the interests of current and future users while also facilitating the economic development of Dublin Airport and enabling its financial viability by better aligning the remuneration with the estimated timeline of delivery of the North Runway. In this Draft Decision, we also aim to incentivise Dublin Airport to deliver the North Runway in a timely manner.

Interim Treatment of the North Runway Trigger

3.10 The 2014 Determination trigger allows Dublin Airport to collect an additional €0.59 from 1 January 2016. Chart 3.1 shows the price cap paths from 2015-2019 with and without the North Runway trigger entering the price cap in 2016 as per the 2014 Determination. Following agreement with the Commission, Dublin Airport has not collected the €0.59 in 2016 and does not plan to do so in 2017.

3.11 If it had done so, in 2016 it would have collected approximately €16.5m which corresponds to the return on capital and depreciation for €247m of allowed expenditure. However, construction of the main project will not start until Q2 2017 and the benefits of the North Runway are not likely to start accruing until 2020.

Chart 3.1: Price Cap with and without North Runway Trigger in 2016 as per 2014 Determination



**Dublin Airport anticipates completing the Pier 2 Segregation project in 2017. We assume that this trigger (€0.06) enters the price cap in the same year.*
Source: CAR 2014 Determination

3.12 Without the 2014 trigger, the base price cap was €9.87 in 2016 and is €9.45 in 2017.[8] This advice means that the 2014 trigger has not been collected and therefore the Commission will not begin depreciation of the project. Following this Interim Review, the Commission will decide on the North Runway trigger(s), and following the satisfaction of the decided trigger(s), the undepreciated capital allowance will enter the RAB. Section 6 explains the reconciliation process that will be carried out at the time of the next Determination.

8 The provisional 2017 price cap adjusted for inflation, triggered projects and under collections in 2015 is €9.86. If the Pier 2 segregation project is completed in 2017, the price cap will be revised up to €9.92 (Figures in October 2016 prices). See Commission Notice 3/2016:
http://www.aviationreg.ie/_fileupload/price%20cap%20statement%202017/2017%20Price%20Cap%20statement.pdf

4. Draft Decision

Decision to Amend the 2014 Determination

4.1 The Commission has reviewed the 2014 Determination of the Maximum Level of Airport Charges at Dublin Airport and proposes to amend it in relation to the North Runway trigger in order to protect the reasonable interests of current and prospective users.

4.2 The 2014 Determination trigger was reached in 2015, but the earliest construction is expected to commence is 2017 and it is not expected to be operational before 2020. The original trigger would negatively affect the interests of users who would pay the full funding costs of the North Runway for a number of years before being able to benefit from it. The 2014 trigger means that users in 2016 would have paid €16.5m for a North Runway that has not commenced construction to date.

Proposed Amendment

4.3 The Commission proposes to replace the 2014 trigger in its entirety. We will remove the demand element of the trigger as the required 25 million passengers in a 12 month period has now occurred. We propose three triggers for the North Runway project at Dublin Airport based on three major project milestones shown in Table 4.1. The proposed triggers allow the remuneration of 10% of the North Runway project allowance (€24.7m) on the year that follows the start of construction of the main project, 85% of the allowance (€209.7m) in the year after the North Runway has become fully operational, and 5% of the allowance (€12.3m) in the year after the house buyout closes and the project is complete.

Table 4.1: Draft Triggers and Construction Milestones of the North Runway

Milestone Number	Name	Proportion of Total Expenditure	Estimated Timeline by Dublin Airport	Allowed Capex	Proposed Triggers
M1	Main Construction Start	10%	2017	€24.7m	€0.06 in the year after M1.
M2	North Runway Fully Operational	85%	27 months after M1	€209.7m	€0.50 on the year after M2.
M3	House Buy-out Closure	5%	36 months after M2	€12.3m	€0.03 on the year after M3.
	Total	**100%**		**€246.7m**	**€0.59**

Source: CAR, Dublin Airport Milestones, Timeline and Expenditure Plan.

4.4 The description of the proposed three major milestones for the draft triggers and their corresponding evidence of accomplishment is summarised in Table 4.2. All other conditions relating to the North Runway as stated in the 2014 Determination still apply, for example those concerning the cross wind runway.

4.5 These proposed triggers provide a strong incentive to Dublin Airport to deliver a fully operational North Runway in a timely manner and minimising the risk of project delay. The proposed triggers protect the interest of current and future users, while facilitating the economic development and enabling the financial viability of Dublin Airport.

Table 4.2: Achievement of Proposed Milestones

Milestone Number	Name	Evidence of Accomplishment
M1	Main Construction Start	-Receipt of letters of discharge from Fingal County Council for all pre-commencement conditions, -Evidence of physical work onsite for main project, and -Evidence that enabling works are complete.*
M2	North Runway Fully Operational	-Construction and commissioning of the North Runway are complete, -The North Runway is fully operational resulting in additional movements being available for slot allocation, -The North Runway is being used for revenue generating scheduled flights, and -The house and school insulation schemes are complete.
M3	House Buy-out Closure	-Dublin Airport issues formal notification that buyout scheme has closed, -Other mitigation measures are complete, and -The Project is complete.

**Enabling works include: site clearance, road diversions, fencing, and services diversions (DAA CIP 15.6.051).*
Source: CAR, Dublin Airport Milestones, Timeline and Expenditure Plan, CIP 2015-2019.

Capital Costs

4.6 The capital costs (depreciation and return on capital) for the North Runway are calculated for the asset life of the project using annuities. This method calculates the same capital costs for the project in each year of its asset life. Table 4.3 displays the assumptions made to calculate capital costs.

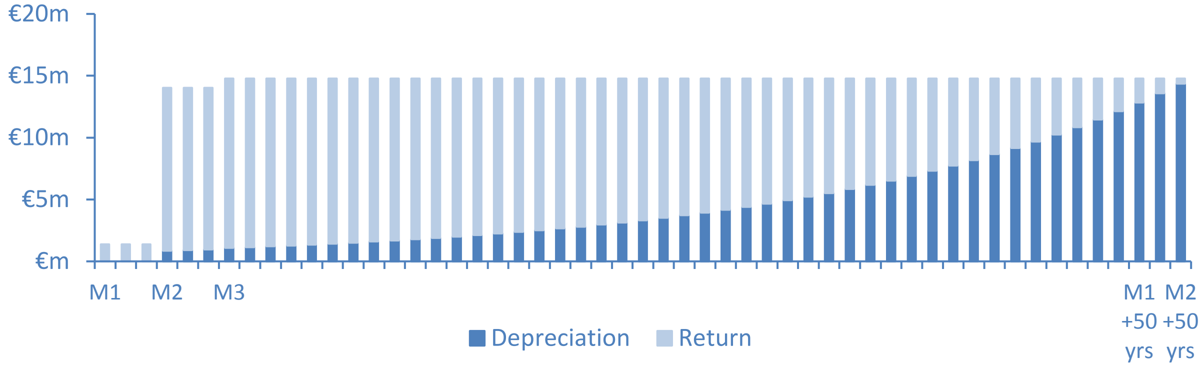
Table 4.3: Assumptions of the Depreciation Profile

Milestone	Asset Life	Method	WACC
M1 and M2	50 years	Annuities	5.79%
M3	50 years – x*		

** X= years elapsed between M2 (North Runway Fully Operational) and M3 (House Buy-out Closure).*
Source: CAR 2014 Determination.

4.7 Chart 4.1 shows the profile of depreciation and return on capital of the North Runway for the total asset life of the project using the assumptions in Table 4.3. These calculations are similar to the 2014 Determination, but are adjusted to take account of the phasing of remuneration of the proposed triggers.

Chart 4.1: Depreciation and Return on Capital Profile of the North Runway as per Draft Triggers



Source: CAR Calculations, 2014 Determination.

Future Determinations

4.8 In future determinations, the return will be adjusted for any changes in the cost of capital. Both the return and the depreciation will be adjusted for changes in the price level. Chart 4.1 gives a possible depreciation profile, but as always, depreciation remains a policy decision of future determinations (although any changes would be NPV neutral).

Volume Risk

4.9 In the 2014 Determination, Dublin Airport was allocated only part of the volume risk on the North Runway. The passenger numbers used to calculate the 2014 trigger were different to those for the price cap. If the 2014 trigger was to have been reached Dublin Airport would have served 25m passengers in a 12 month period, therefore 25m passengers per annum was used in the 2014 trigger calculations.

4.10 The Commission proposes that Dublin Airport will not take any of the volume risk on this project. Here we are revisiting the 2014 trigger but we are not updating the passenger forecasts of the 2014 Determination, therefore it would not be in the interest of users to leave the volume risk of the project with Dublin Airport while using the 2014 Determination passenger number forecasts. For this reason, in future determinations we will:

- Calculate the return on capital collected by the proposed triggers using outturn passenger numbers; and
- Adjust the depreciation of the project according to the under/over collection of allowed return on capital due to outturn passengers being below/above 25m passengers per year, which was the traffic used to calculate the 2014 Determination trigger. Depreciation is projected to start after M2. However, if outturn traffic exceeded forecasts the additional revenue from M1 would start depreciation early.

4.11 An example of the reconciliation of outturn revenues, if actual passenger numbers are higher than 25m passengers per year is shown in Table 4.4. In this case, the over collection (outturn revenues minus allowed revenues) is added to the total depreciation, and vice versa for the opposite case.

Table 4.4: Example of Reconciliation Using Higher Outturn Passenger Numbers

Draft Parameters	M1
Draft Trigger	€0.06
Depreciation	€0*
Passengers for Draft Trigger calculation	25m
Allowed Revenues	€1.5m
Reconciliation Example	
Outturn Passengers	28m
Outturn Revenues	€1.7m
(Extra) Depreciation (Over collection)	€0.2m
Total Depreciation	€0.2m

** Depreciation is projected to start after M2, unless there are over collections during M1.*
Source: CAR Calculations, 2014 Determination

Timing of Remuneration

4.12 This Interim Review is concerned with the timing of remuneration of the North Runway, through an increase in the price cap. In order to protect the interests of current and future users most of the remuneration of the project will occur when users are receiving the benefits of the North Runway. This prevents a situation where users would pay for infrastructure that is not operational. The proposed triggers closely emulate conditions that a competitive firm would experience, although the Commission acknowledges that a competitive firm would have less certainty in its ability to charge for the project so soon after it becoming operational as the timing of remuneration would depend on demand.

4.13 Not having excessive pre-funding provides the strongest incentive for on-time delivery of the North Runway. This incentive is in line with our statutory objective to facilitate the efficient and economic development and operation of Dublin Airport which meet the requirements of current and prospective users of Dublin Airport.

4.14 It is the view of the Commission that there are no liquidity concerns or financial viability risks arising from this Draft Decision. When the airport has cost-effective access to financial markets, this approach should be preferred to protect the interest of current and future users. Our financial analysis in Section 5 shows that Dublin Airport would have significant funds from operations to put towards financing the North Runway. We also believe that Dublin Airport is able to raise new debt for the North Runway at favourable conditions due to the current low price of debt for a low-risk government-owned company such as daa. In May 2016, S&P affirmed an A- rating for daa based on its "*strong operational growth in 2015*", "*dominant market position*" and strong liquidity among other factors.[9] Our financial analysis shows that the proposed triggers enable the financial viability and sustainability of Dublin Airport even if passenger numbers do not continue to grow or in fact decline considerably.

Recent Examples of Projects without Prefunding

4.15 There was no pre-funding for the construction of Terminal 2 (T2), which is the largest project at Dublin Airport since price cap regulation started in 2001. In the 2007 Interim Review (CP6/2007), the Commission decided that there would be a two-box approach to including the costs of T2 in the RAB. Box 1 consists of (86%) of T2 costs which entered the RAB when T2 opened for operations, while box 2 (14%) will be added if and when passenger numbers exceed

[9] S&P Global Ratings' Credit Research. "Research Update: Irish Airport Authority DAA PLC Ratings Affirmed At 'A-' On Strong Operating Performance; Outlook Stable" May 20, 2016. Alacra Store. Jan 10, 2017.

33m.[10] The T2 trigger in the 2007 Interim Review was designed to provide Dublin Airport with incentives to build T2 within the original timescale set out in the 2005 Aviation Action Plan.[11] The 2014 Determination included a total of €735m in the RAB corresponding to box 1.[12]

4.16 The Pier 2 segregation trigger is another example of no pre-funding. It allows an increase in the price cap in the year in which segregation of departing and arriving passengers in Pier 2 occurs, provided it is mandated by a relevant regulatory authority prior to the end of 2019.[13] Pier 2 segregation was mandated in 2016 and it is expected to be complete by 2017.

4.17 For other triggered projects the Commission has allowed prefunding, such as the Hold Baggage Screening (HBS) trigger set in the 2009 Determination. This trigger consisted of an increase in the price cap as soon as legislation required Dublin Airport to upgrade its baggage security system to Standard 3 prior to 2015.[14] When this trigger was hit in 2014, it had an immediate impact on airport charges, irrespective of the timeline of expenditure or delivery of the system.

10 http://www.aviationreg.ie/_fileupload/Image/PR_AC2_PUB1_CP6_2007.pdf
11 http://www.aviationreg.ie/_fileupload/2009_CP4_Final%20Determination_4DEC.pdf
12 The 50/50 risk sharing mechanism was applied to T2 overspend.
13 http://www.aviationreg.ie/_fileupload/2014final/2014%20Final%20Determination.pdf
14 http://www.aviationreg.ie/_fileupload/2009_CP4_Final%20Determination_4DEC.pdf

5. Financial Viability

5.1 In arriving at these proposed triggers for the North Runway, the Commission has had due regard to its statutory objective of enabling the sustainability and financial viability of Dublin Airport and to the statutory factors that apply to this Draft Decision such as the capital expenditure requirements relating to the North Runway, the ongoing levels of investment of the CIP for 2015-2019, as well as the levels of income, costs and liabilities of Dublin Airport.

5.2 We examined the forecast financial metrics of the regulated entity only, not daa group as a whole, for the period 2016-2024, comparing them with the minimum levels required by Standard and Poor's (S&P) to maintain a credit rating of BBB. This is the minimum credit rating required for an investment grade rating and is the same approach taken in the 2014 Determination. In addition, we stress tested this in three passenger volume scenarios set out below that include two negative scenarios of stagnating or significantly declining passenger traffic after 2018.

5.3 Table 5.1 summarises the financial metrics we analysed and gives the S&P requirement for a BBB rating for low volatility companies.

Table 5.1: Financial Metrics and Minimum Targets to Maintain a BBB Credit Rating (S&P)

Financial Metric	Target
Funds From Operations / Net Debt	> 13%
Debt / EBITDA (x)	< 4
Funds From Operations: Cash Interest (x)	> 3
EBITDA / Interest (x)	> 4

Source: 2013 Corporate Methodology, S&P RatingsDirect®, 19 Nov 2013

2015 Outturns of Dublin Airport

5.4 The financial outturns reported in the 2015 regulatory accounts of the Dublin Airport only entity have exceeded the forecasts of the 2014 Determination. This is largely driven by 2015 passenger numbers being 13.3% higher than our estimations. As shown in Table 5.2, the 2015 outturn EBITDA, funds from operations and free cash flow were, respectively, 15%, 12% and 59% higher than our forecast.

Table 5.2: 2015 Outturn Financial Results are healthier than 2014 Determination Forecast

	2015 CAR Forecast	2015 Outturn	Increase
Passengers	22.1m	25m	13%
EBITDA	€173.9m	€199.6m	15%
Funds From Operations	€138.6m	€154.9m	12%
Free Cash Flow	€ 21.3m	€ 33.8m	59%

Source: daa Regulatory Accounts, CAR 2014 Determination Financial Model.

North Runway Capex and Draft Triggers

5.5 The financial viability of Dublin Airport is analysed for 2016-2024, during which period we assume that the North Runway capex will occur and will satisfy the proposed triggers. The dates assumed by the Commission are for the purposes of this financial viability analysis only.

5.6 The capital expenditure for the North Runway is based on the "*Information on milestones, timeline and expenditure plan*" provided to the Commission by Dublin Airport in November 2016, according to which it expects to spend:

- 10% of the total project cost in 2017,
- 25% at the start of the main contract and 25% mid-project (which for the purpose of this financial analysis we estimate to happen in 2018 and 2019, respectively), and
- 35% by the end of construction and commissioning of the North Runway, currently expected to be around 2020.
- 5% for close out of mitigation efforts

5.7 Table 5.3 displays the milestones and timeline used for assessing the financial viability of the regulated entity.

Table 5.3: Estimated North Runway Capex and Draft Triggers

Estimated values	2017	2018	2019	2020	2021	2022	2023	2024
Assumed Capex (% Total)	10%	25%	25%	35%			5%	
Milestones	Project Start	Main Contract Start	Mid-project	Construction / Commissioning / Insulation complete			House Buyout Closes	
Assumed Capex (€ m)	24.7	61.7	61.7	86.4			12.3	
Draft Triggers (€)		0.06			0.50			0.03

Source: Dublin Airport 2016 Milestones, Timeline, Expenditure Plan, CAR 2014 Determination.

Forecasts

5.8 To estimate the financial viability, we use Dublin Airport outturn of 28m for 2016 which represents a 12% increase compared to 2015. From 2017-2024 we use three passenger volume scenarios:

- Scenario 1: Passenger growth (3% per year from 2017-2024),
- Scenario 2: Passenger stagnation (3% in 2017 and 0% from 2018-2024), and
- Scenario 3: Passenger decline (0% in 2017, -12% in 2018, -8% in-2019 and 0% from 2020-2024).

5.9 Scenario 1 sees the current high growth revert to a longer-term trend of slower growth. Scenario 2 sees the growth period end in 2018 with stagnant traffic thereafter. Scenario 3 assumes that passenger volumes decline at a similar proportion to the 2008-2009 decline and do not recover after.

5.10 Aeronautical revenues of the three scenarios were calculated by multiplying the updated passenger forecast with a 2014 Determination base price cap that includes the proposed North Runway triggers and the Pier 2 Segregation trigger (expected to hit in 2017).

5.11 Commercial revenues (CR) and operating expenditure (opex) are estimated by the financial model of the 2014 Determination using updated passenger forecast for the three scenarios. The estimated CR and opex do not assume any increasing economies of scale, opex savings or opportunities for increasing CR that Dublin Airport may take advantage of, according to varying traffic volumes. This makes our estimated scenarios reasonable worst cases for the purpose of this financial viability analysis. As shown in Table 5.4, the 2015 outturn per-passenger CR are 7.8% higher and opex -3.5% lower than those estimated in the 2014 Determination.

Table 5.4: Higher 2015 per-passenger CR and Lower Opex than 2014 Determination Forecast

Per-passenger	2015 CAR Forecast	2015 Outturn	Change
Commercial Revenues (CR)	€6.58	€7.09	7.8%
Operational Expenditure (Opex)	€9.01	€8.69	-3.5%

Source: daa Regulatory Accounts, CAR 2014 Determination, July 2014 prices.

Financial Analysis

5.12 The Profit & Loss and cash flow statements, and financial metrics of these scenarios for the current regulatory period 2016-2019 are shown in Table A.1 in Appendix 1. Under the three scenarios, the financial metrics during 2016-2019 are well above the minimum S&P targets. These results show that the proposed triggers enable the financial viability and sustainability of Dublin Airport, even if passenger numbers do not continue to grow or in fact decline in an unforeseen manner.

5.13 Our financial projections estimate that Dublin Airport would have significant funds from operations to put towards financing the North Runway should it choose. In addition, current market conditions would suggest it could inexpensively raise debt on the bond markets. In May 2016, daa raised €259.4m in bonds at a nominal rate of 1.55%, this compares to the real cost of debt of 3% allowed in the 2014 Determination.[15]

5.14 The Commission is of the view that Dublin Airport should be able to raise new debt for the North Runway at favourable terms. In May 2016, S&P affirmed an A- rating for daa for "*strong operational growth in 2015, with revenues increasing by 20.5% and adjusted EBITDA by 9.9% as a result of traffic growth at Dublin airport (+15.4% traffic growth) reaching over 25 million passengers…. Furthermore, daa has a dominant market position, handling about 91% of air passengers in Republic of Ireland in 2015 (84% only at Dublin airport)."* [16]

5.15 In addition, the Commission enables the Airport to continue having a credit rating of BBB by having due regard to its efficient development and operation, as well as enabling its financial viability and sustainability when making any regulatory decision. [17]

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[15] http://www.irishtimes.com/business/transport-and-tourism/airport-operator-daa-sells-400m-bond-hot-on-heels-of-esb-1.2668390

[16] S&P Global Ratings' Credit Research. "Research Update: Irish Airport Authority DAA PLC Ratings Affirmed At 'A-' On Strong Operating Performance; Outlook Stable" May 20, 2016. Alacra Store. Jan 10, 2017.

[17] We note that S&P upgraded the rating of daa to A- from BBB+ in November 2015, which confirms the low-risk (low cost) conditions for Dublin Airport to finance its projects through debt.

6. Outturn Cost Reconciliation - Treatment of Over or Underspends

6.1 Dublin Airport has indicated that the expected outturn expenditure for the North Runway may be higher than the €247m allowance set in the 2014 Determination. It has also indicated that significant uncertainty on the cost will remain until such a time as tendering for the project is complete.

6.2 The 2014 Determination outlines how any over or under-spends will be treated when reconciling outturn expenditure with the allowance for the project:

> *"When reconciling the [North Runway], we will use a 50/50 mechanism to share the risk of over or under-spends between DAA and the users. This is consistent with how we have treated the T2 overspend. If DAA spend under the allowance they will retain 50% of the underspend while 50% will be clawed back. If DAA overspend 50% of the overspend will be passed on to users."*

This mechanism provides Dublin Airport with a strong incentive to maintain control of costs. However, it comes with risks, for example, for large potential overspends on the project it may not be feasible for Dublin Airport to proceed or on the other hand an unknown cost may be passed on to users without proper consultation or consideration of the benefit.

6.3 In CP6/2016 we decided that substantial grounds did not exist to include the 50/50 risk sharing treatment in this Interim Review, therefore the 50/50 treatment remains as stated above.

6.4 This treatment was introduced as a way of dealing with cost overruns on Terminal 2. The cost of T2 was 20% higher than the allowance. The key difference between T2 and the North Runway is that prior to commencing construction of the Runway, Dublin Airport anticipates that the cost may be 30% higher than the allowance, whereas the cost overrun on T2 was only fully known after completion of the project.

Constructive Engagement

6.5 The Commission believes that constructive engagement between Dublin Airport and users on project cost would produce a better outcome than the 50/50 risk sharing. The Commission would assess both the outcome of the engagement and the efficiency of the spend before deciding on the amount to enter the RAB. This process would follow the reasoning of the RAB Roll forward principles first outlined in Annex 3 of the 2009 Draft Determination.[18]

6.6 If Dublin Airport was to engage constructively with users on this now, at the time of a future determination, when reconciling the expenditure, there may be grounds for the Commission to move away from the 50/50 rule. For us to do so, we would expect Dublin Airport and users to have followed the process outlined below.

6.7 If it is demonstrated that Dublin Airport has actively engaged with users to achieve the desired project at an efficient cost this would signify a significant change in the way the Airport and airlines work together, and would constitute grounds for the Commission to change its approach to reconciling the project.

[18] http://www.aviationreg.ie/_fileupload/2009_07_06_draft_determination_redacted_version.pdf

Process for Consultation, Transparency and Efficiency Assessment

6.8 In order for us to apply a different treatment to this project in future determinations we would need to see the following criteria fulfilled:

- A detailed reason for each driver of cost change should be provided to users;
- Where a change in cost is driven by a change in scope in the project, users should be consulted on the need and benefit of such a scope change;
- Where cost changes are driven by a change in scope due to regulatory change a detailed explanation should be provided to users on what has changed from 2014, what options the Airport has in terms of meeting the regulatory requirement and the cost implication of these options; and
- Users should be given the opportunity to engage with Dublin Airport on the need and desirability of any changes.

6.9 Ideally, a consensus would be reached. Where the cost change is driven by regulatory change or the cost of materials for example this would not be necessary. Where the cost change is driven by changes in the scope of the project to meet user needs, users responsible for 80% of traffic should be in agreement with the changes.

6.10 The Commission would observe this process. In addition, at the end of the project it would assess the expenditure to ensure it was efficiently incurred.

7. Compliance with Statutory Requirements

7.1 This Draft Decision complies with our statutory requirements. Our statutory objectives, as well as the statutory factors to which we must have regard, are set out in Section 33 of the 2001 Airport Aviation Act, as amended by Section 22(4) of the 2004 State Airports Act. Below we set out how this Draft Decision complies with the statutory objectives and factors that apply.

Statutory objectives

7.2 When amending a determination for airport charges, we must have due regard to three statutory objectives.

To protect the reasonable interests of current and prospective users of Dublin Airport in relation to Dublin Airport

7.3 The draft triggers protect the interest of current and future users. It is estimated by the Commission that the 2014 trigger would have resulted in users paying €16.5m in 2016 for the remuneration of the North Runway without having received any benefit. The proposed triggers will protect the interest of current and future users by ensuring that, for the most part, users will only pay for the North Runway when the benefits are available to be realised. The draft triggers allow very little prefunding therefore users only start paying for the project after the North Runway is commissioned and becomes fully operational.

To facilitate the efficient and economic development and operation of Dublin Airport which meet the requirements of current and prospective users of Dublin Airport

7.4 The Commission is of the view that the proposed triggers facilitate the efficient and economic development of Dublin Airport by giving certainty of remuneration for the project to allow it to proceed and facilitate the meeting of requirements of current and prospective users by providing the right incentives to Dublin Airport namely the timely delivery of a fully operational North Runway and the minimisation of the risk of project delay. The Commission also has regard to this objective by ensuring the depreciation profile returns the capital employed by the project over its lifecycle.

To enable Dublin Airport Authority to operate and develop Dublin Airport in a sustainable and financially viable manner

7.5 In making this Draft Decision, the Commission has had due regard to the sustainability and financial viability of Dublin Airport. We have assessed the airport's financial metrics against the minimum levels accepted by Standard and Poor's (S&P) to maintain a target credit rating of BBB as set out in the 2014 Determination, and performed stress testing of worst case scenarios such as stagnating or declining passenger traffic after 2018.

7.6 Under the three scenarios, the financial metrics during the regulatory period 2016-2019 are well above the minimum S&P targets. These results show that the proposed triggers enable the financial viability and sustainability of Dublin Airport, even if passenger numbers do not continue to grow as expected or decline drastically in a presently unforeseen way.

7.7 The Commission believes that Dublin Airport is well positioned to raise new debt for the North Runway, if it wished to do so, at favourable conditions due, among other factors, to the regulatory environment and its dominant market position that give a degree of certainty to Dublin Airport about aeronautical revenues and cash flows over regulatory periods and lower its company risk.

Statory Factors

7.8 In arriving at these proposed triggers for the North Runway, the Commission has had due regard to the following statutory factors that apply to this Draft Decision.

The level of investment in airport facilities at Dublin Airport, in line with safety requirements and commercial operations in order to meet the needs of current and prospective users of Dublin Airport

The level of operational income of Dublin Airport Authority from Dublin Airport, and the level of income of Dublin Airport Authority from any arrangements entered into by it for the purposes of restructuring under the State Airports Act 2004

Costs or liabilities for which Dublin Airport Authority is responsible

7.9 Our financial viability analysis of the draft triggers has due regard to the capital expenditure requirements relating to the North Runway and the ongoing levels of investment of the CIP of Dublin Airport for 2015-2019, as well as the operational income, cost and liabilities that were allowed in the 2014 Determination. The Commission considers that they constitute an efficient level of investment, income and cost that meet the interests of current and prospective users, as well as the safety requirements and commercial operations needs of Dublin Airport.

The level and quality of services offered at Dublin Airport by Dublin Airport Authority and the reasonable interests of the current and prospective users of these services

7.10 In the interests of current and future users, the draft triggers aim to minimise the disruption during the construction of the North Runway in the level and quality of services offered at Dublin Airport by providing the right incentives to Dublin Airport to timely deliver a fully operational North Runway and minimising the risk of project delay.

The cost competitiveness of airport services at Dublin Airport

7.11 The proposed triggers have due regard of the cost competitiveness of airport services at Dublin Airport by ensuring that, for the most part, users will only pay for the North Runway when it is commissioned and the benefits are available to be realised. This emulates more closely the outcome of a competitive market.

8. Responding to the Draft Decision

8.1 We would like to hear the views of interested parties about the proposals in this Draft Decision. Respondents are asked to support any views expressed in submissions with relevant evidence where possible.

8.2 Responses should be titled "Response to Draft Decision on the Interim Review of the 2014 Determination" and sent:

- By email to: Info@aviationreg.ie (preferable); or

- By post to: 3rd Floor, Alexandra House, Earlsfort Terrace, Dublin 2, D02 W773

8.3 The closing date for receipt of submissions is **5pm, 3 March 2017**. The time of receipt of representations, whether in electronic form or otherwise, shall be the time when we actually receive the representations at or in our offices. Submissions received after the deadline will be deemed not to have been received and we will not consider them. If we receive a portion of a representation prior to the deadline, and the remainder after the deadline, we will only consider the portion received prior to the deadline.

8.4 We may correspond with interested parties who make submissions, seeking clarification or explanation of their submissions. Such correspondence will not be an invitation to make further submissions.

8.5 Respondents should be aware that we are subject to the provisions of the Freedom of Information legislation. Ordinarily we place all submissions received on our website. We may include the information contained in submissions in reports and elsewhere as required. If a submission contains confidential material, it should be clearly marked as confidential and a redacted version suitable for publication should also be provided.

8.6 We do not ordinarily edit submissions. Any party making a submission has sole responsibility for its contents and indemnifies us in relation to any loss or damage of whatever nature and howsoever arising suffered by us as a result of publishing or disseminating the information contained within the submission.

8.7 While we endeavour to ensure that information on our website is up to date and accurate, we accept no responsibility in relation to the accuracy or completeness of our website and expressly exclude any warranty or representations as to its accuracy or completeness.

APPENDIX 1. Financial Viability of Dublin Airport

Table A.1: Financial Viability of Dublin Airport in 3 Scenarios

Data[1]	Outturn	CAR Forecast - Scenario 1				Outturn	CAR Forecast -Scenario 2				Outturn	CAR Forecast - Scenario 3			
Parameters	**2015**	**2016**	**2017**	**2018**	**2019**	**2015**	**2016**	**2017**	**2018**	**2019**	**2015**	**2016**	**2017**	**2018**	**2019**
Passenger growth		12%	3%	3%	3%		12%	3%	0%	0%		12%	0%	-12%	-8%
Passenger numbers (m)	**25.0**	**28.0**	**28.8**	**29.7**	**30.6**	**25.0**	**28.0**	**28.8**	**28.8**	**28.8**	**25.0**	**28.0**	**28.0**	**24.8**	**22.9**
North Runway trigger (€)				**0.06**					**0.06**					**0.06**	
Pier 2 Segregation trigger (€)			**0.06**					**0.06**					**0.06**		
Price cap (€)		9.87	9.52	9.18	8.80		9.87	9.52	9.18	8.80		9.87	9.52	9.18	8.80
Profit and Loss Account (€m)															
+Aeronautical Revenue	240.4	276.3	274.5	272.6	269.1	240.4	276.3	274.5	264.7	253.7	240.4	276.3	266.5	227.4	201.6
+Commercial Revenue	177.5	169.4	178.4	182.8	187.4	177.5	169.4	178.4	179.2	180.1	177.5	169.4	174.9	162.2	155.4
-Opex	217.8	205.4	206.1	207.8	209.5	217.8	205.4	206.1	206.7	207.3	217.8	205.4	205.1	201.6	199.9
=EBITDA	**199.6**	**240.4**	**246.8**	**247.6**	**247.1**	**199.6**	**240.4**	**246.8**	**237.1**	**226.4**	**199.6**	**240.4**	**236.3**	**188.0**	**157.2**
Cash Flow (€m)															
Funds From Operations (FFO)[2]	154.9	199.9	209.2	212.4	214.5	154.9	199.9	209.2	203.3	196.2	154.9	199.9	200.0	160.0	134.2
-Capex (except triggers)	66.0	83.5	71.6	61.6	61.6	66.0	83.5	71.6	61.6	61.6	66.0	83.5	71.6	61.6	61.6
North Runway trigger			**24.7**	**61.7**	**61.7**			**24.7**	**61.7**	**61.7**			**24.7**	**61.7**	**61.7**
Pier 2 Segregation trigger			18.1					18.1					18.1		
-Dividends	18.4					18.4					18.4				
-Pension	55.0					55.0					55.0				
=Net Cash Flow	**15.4**	**116.4**	**94.8**	**89.2**	**91.2**	**15.4**	**116.4**	**94.8**	**80.0**	**72.9**	**15.4**	**116.4**	**85.6**	**36.8**	**11.0**
(Closing) Net Debt (€m)	**790.3**	**669.3**	**574.5**	**485.2**	**394.1**	**790.3**	**669.3**	**574.5**	**494.4**	**421.5**	**790.3**	**669.3**	**583.7**	**546.9**	**535.9**
Financial Metrics Target[3]															
FFO/Net Debt **> 13%**	20%	30%	36%	44%	54%	20%	30%	36%	41%	47%	20%	30%	34%	29%	25%
Debt / EBITDA (x) **< 4**	3.96	2.78	2.33	1.96	1.60	3.96	2.78	2.33	2.09	1.86	3.96	2.78	2.47	2.91	3.41
FFO : Cash Interest (x) **> 3**	3.46	8.48	10.42	12.33	14.73	3.46	8.48	10.42	11.79	13.23	3.46	8.48	9.96	9.14	8.18
EBITDA / Interest (x) **> 4**	4.46	10.20	12.29	14.37	16.97	4.46	10.20	12.29	13.76	15.26	4.46	10.20	11.77	10.74	9.58

1. Outturn: daa Regulatory Accounts 2015 in July 2014 prices. CAR Forecast: CR/Opex adjusted by updated passenger forecast, 2014 Determination.
2. Funds From Operations = EBITDA - Interests – Tax
3. S&P targets for at least intermediate financial risk for low volatility company (BBB credit rating).
Source: CAR Calculations, July 2014 prices.