International Air Transport Association (IATA) response to the Commission for Aviation Regulation's (CAR) Draft Determination CP 3/2009 of 18 June 2009 on the Maximum Levels of Airport Charges at Dublin Airport

1. INTRODUCTION

Airlines are operating in an increasingly competitive and deregulated business that is driving essential cost reduction and improved efficiency. We have reduced non-fuel unit costs some 14% over the last five years, with a 33% improvement in labour productivity. Fuel is still some 26% of our total operating costs, and more worryingly the fuel price is showing signs of increasing. Competition has driven down our real yields some 30% over the last 10 years. Airlines are continuously reducing costs in line with consumers' demands.

Major airports such as Dublin are monopoly providers of essential services and facilities for the airlines. More than ever we need regulatory support and incentives to ensure the lowest possible costs and charges consistent with the provision of the agreed necessary capacity and service. We fully support the requirement for strong robust and independent economic regulation to protect airlines and their passengers in the absence of sufficient competition. We therefore welcome the opportunity to respond to the CAR Draft Determination.

2. DRAFT DETERMINATION

We are pleased to note the draft determination proposes a robust RPI-3.8% adjustment in each of the four subsequent years of the control period. We believe this provides the necessary pressure for continuous improvement and cost-efficiency. We are very concerned however with the significant increase to the initial 2010 price cap to EUR 8.35. Against the background of the current industry crisis, together with the increasingly competitive situation which is drastically reducing yields and revenues, we are asking all providers and their regulators for reductions and at least a freeze in charges. In our view the EUR 8.35 proposal is therefore unreasonable and unacceptable.

Approach to Regulation

We support the continued application of RPI-X price caps based on the regulated asset base and single-till, for five-year periods.

Single Till

We firmly believe that the single till is the fairest mechanism of charging airlines users, and is a clear recognition that airlines and the passengers they deliver to the airports are a key factor in the ability to develop commercial revenues at an airport. It is an acknowledgement of the symbiotic and essential relationship between airports and airline users, and allows airports to increase retail and commercial revenues while decreasing charges to airlines and their passengers.

There is no evidence that application of the dual till provides better incentives for airports to make timely investments than single till. Moreover, the dual till can potentially incentivise airports to invest in potentially higher-return commercial activity rather than essential aeronautical infrastructure.

Quality of Service

We have consistently proposed and supported the introduction of service quality regimes (SQR) at airports. These reduce the temptation for “thrifting” by airports challenged with economic regulation. We therefore welcome the CAR proposals to introduce such a SQR scheme at Dublin. We also agree the scheme should be based on penalties without bonuses, on the basis that the basic service and facilities are provided within our charges by a supplier with strong market power. The application of bonuses could be considered a double-payment or reward for what we are already paying for.

While it is recognized the scheme is unlikely to directly compensate airlines or their passengers for delay or service quality failures, it does focus airport management attention on those elements that are important to the airlines and their customers. Clearly our priority is for “hard” standards that directly impact our service and punctuality, but the agreement on the elements, targets and penalties should be through the on-site DACC/AOC.

3. PASSENGER FORECASTS

We recognize that traffic development at Dublin is very closely linked to Irish GDP performance, and that the recently introduced Government Air Travel Tax together with the proposed ETS will inevitably have an adverse impact on demand. Nevertheless, we note that the draft determination assumes a slower return to growth than both EUROCONTROL (for European aircraft movements) and IATA (for global passengers) assume. While we recognize that the EUROCONTROL forecasts include over flying traffic in addition to O&D traffic, they are still a useful general indicator of demand

% growth y-o-y	2007	2008	2009	2010	2011	2012	2013	2014
GDP growth assumptions								
CAR (Ireland)				-1.1%	2.0%	3.0%	4.0%	5.0%
IATA (World)	3.8%	2.1%	-3.0%	0.9%	2.4%	2.9%	3.1%	2.9%
Traffic growth assumptions								
CAR (Dublin)			-11.0%	-1.4%	2.4%	2.8%	4.1%	4.8%
EURCONTROL (movements)	5.0%	0.4%	-4.9%	1.5%	3.7%	4.3%	3.4%	3.6%
IATA (World)	6.4%	-0.8%	-8.0%	0.5%	4.3%	6.4%	6.4%	

The CAR assumption is that traffic levels at Dublin are only just returning to 2008 levels by 2014. On the regional and global level, EUROCONTROL and IATA see a return to pre-2008 rates of growth by around 2012 which could mean passenger numbers at Dublin in the order of 5-10% higher than the CAR assumption by 2014.

Given the dip in traffic due to recession it is indeed likely that passenger numbers will be lower than originally forecast. However, we could question the assertion in paragraph 6.9 that this review period will see no growth and thus the extent of need for the price cap to be raised due to lower traffic demand.

4. OPERATING EXPENDITURE

In our experience operating expenditure has been one of the major sources of cost-efficiencies at economically regulated airport and ATC providers. We are therefore not surprised to note the results of the Indecon/Jacobs study that indicate an estimated 10% saving is possible against 2008 operations. We would query however, why the CAR is unwilling to adopt a more robust target than midpoint, particularly given the assumption that real wages at the DAA will not grow during the regulatory period.

5. CAPITAL COSTS

Triggers

We fully support the introduction of capital investment triggers to ensure timely delivery of projects in line with agreed user requirements and priorities. Our experience indicates such incentives have achieved their objectives at other airports. Specification and timing of such triggers should best be agreed with the airlines operating at Dublin.

Surface Access Costs

We would have concerns at any possible consideration of including surface access costs within the regulated asset base and the possible diversion of aeronautical revenues to surface access. In our view only the costs of essential surface access infrastructure within the airport boundary should be considered for possible inclusion.

Taking into consideration the considerable economic benefits of airports regionally as well as nationally, we believe that financing of surface access schemes should be through the users of the facilities and the usual surface access funding mechanisms.

Cost of capital: some high assumptions

Parameter	Dublin	Gatwick
Real risk free rate (%)	2.5	2.5
Equity-risk premium (%)	5.0	2.5-4.5
Asset Beta	0.61	0.52
Pre-tax real cost of equity (%)	9.9	10.9
Pre-tax real cost of debt (%)	4.1	3.55
Gearing (%)	50	60
Real WACC (pre-tax) (%)	**7.0**	**6.5**

The Commission assumes 7% cost of capital for this assessment period, at the higher end of a range 6.1%-7.1%. We recognize there has been considerable volatility in the financial markets creating even more uncertainty than usual about appropriate assumptions in this regard, but would nevertheless query why the higher end of the scale is selected. This compares to a lower 6.5% cost of capital assumed by the UK CAA for Gatwick (most relevant comparator) for the 2008-13 assessment period.

The equity-risk premium, representing the additional return investors require to invest in equity instead of 'risk free' assets, is 5.0% which is at the top end of the 4%-5% range considered by the commission. This is higher than the 4.5% point estimate assumed by the CAA for Gatwick – a figure which was already at the top end of their considered range. A high equity-risk premium pushes up the cost of capital, so it could be worth questioning this estimate.

The level of gearing affects the balance of debt versus equity and thus the average cost of capital. The 50% gearing assumed for Dublin is 10% lower than the 60% used for the Gatwick assessment – a figure already challenged as low by IATA during that consultation. It is expected that efficiently financed airports would have higher levels of gearing using relatively cheaper debt (compared to cost of equity) which would reduce the average cost of capital. We believe the cost of capital estimate must be carefully reviewed prior to publishing the final determination.

Financial viability: not an excuse

While interest rates are likely to rise slightly from current levels, most expectations are they will remain relatively low (in historical terms) over the assessment period. Airports enjoy relatively stable earnings streams and there have not been examples of airports generally raising cash to cover shortfalls. Concern over the future financial viability of the airport, even in these challenging economic circumstances, should not be overplayed as an excuse for pushing up the price cap. In our view the overall risk is probably lower than comparators.

Airport	2008	2008-9			
		Jan-Jan	Feb-Feb	Mar-Mar	Apr-Apr
Stansted	-6.0	-11.2	-16.1	-15.9	-12.6
Gatwick	-2.8	-10.8	-14.3	-17.6	-3.0
Dublin	**0.8**	**-7.9**	**-11.8**	**-13.9**	**-4.5**

Extract from table 9.20: Annual % change in passenger numbers

In several places (particularly in cost of capital calculation) Dublin is described as being in a 'riskier' position than UK comparators such as Stansted and Gatwick and therefore justify the need for a higher return. In this regard however it should be noted that the traffic figures in table 9.20 of the Draft Determination indicate that traffic at Dublin over recent months generally declined at a slower rate than the UK examples and actually grew in 2008. It could be argued on this basis that Dublin is actually a safer bet than those in the UK and hence more conservative (i.e. lower) assumptions could be used in cost of capital and other risk-based assessments making up the price cap determination.

6. CONCLUSION

We generally support the CAR approach to the Draft Determination but believe that the significant increase in the starting price cap of EUR 8.35 for 2010 is unreasonable and unjustified. We feel there is scope for a more robust starting cap through a less generous cost of capital and increased operating cost efficiency together with application of a more optimistic traffic forecast.

Geneva 7 August 2009