IATA submission in response to the Commission for Aviation Regulation "Draft Determination Airport Charges" on Maximum Levels of Airport Charges at Dublin Airport

31. July 2014

This submission presents the response of the International Air Transport Association (IATA). IATA is the trade association of airlines representing 240 members comprising 84% of the total air traffic.

IATA welcomes the opportunity to provide comments on the Draft Determination for Airport charges at Dublin Airport.

Please find below our responses to the draft determination.

General Comments:

We appreciate the approach taken by the CAR to engage with stakeholders, requesting and considering feedback ahead of the determination for the next regulatory period. Recent consultations on airport charges as well as decisions by regulators have demonstrated the importance of a balanced approach to ensure that market power is regulated effectively. In this regard, airports generally operate in the absence of a competitive environment whereas airlines are actively competing with each other. In such an unbalanced environment, an airport has the persistent potential to use the dominant market position in its favor.

We generally support the approach and the methodology CAR has used for this draft determination. While the draft document is clear and consistent in its approach, we have identified some elements which to our view require clarification or adjustment and which will be addressed in more detail in the following section. These adjustments provide scope for further reducing the proposed charges.

Furthermore, it has come to our attention that the DAA is undertaking efforts through bilateral meetings engaging with stakeholders in order to achieve a change in the draft determination. With regards to the allowed capital expenditure, we will provide our and the airline's view in the following section. On the CAR approach towards the determination of the allowed cost, we generally agree with the methodology and the result however we will address several elements with need for adjustment.

Specific Comments:

Passenger Forecast

In general, we are not opposing econometric modeling for medium to long term forecasting for 5 year periods. However, in addition to the use of econometric modeling, which is primarily based on ex-post data, the traffic forecasts from the airport users need to be taken into consideration. In that context, the paragraphs mention "stakeholder inputs", yet we are not aware of which input has been provided by airlines. It is evident to us that only data provided by the airport has been considered. Moreover, we are surprised that the CAR is calculating traffic below what has been proposed by DUB. The traffic forecast is a major element in determining airport charges as a faster growth in passenger numbers tends to reduce the allowed maximum per passenger charge. We are aware that the airport carries the traffic risk, which is why there is a general tendency from airports to understate future traffic potential.

As further explained in Appendix A attached to this document, IATA's Airline Industry Forecast outlines a different growth rate for traffic with a CAGR of 4.2% over the considered time period.

Verifying this forecast with the expectations of GDP growth, by taking into consideration the expected GDP growth rates for international destinations served from Dublin and a conservative estimate of the median elasticity between GDP and traffic growth of 2.0, underlines the appropriateness of IATA's traffic forecast for Ireland. You will find the detailed calculation in Appendix A.

It is IATA's view that calculating the passenger forecast should not be purely done on one input variable which is the GDP growth, as passenger numbers will be impacted by supply side and demand side effects. In addition we are concerned that an elasticity of 1.15 is used as the relation between the Irish GDP and a change in passenger numbers. This indicates a significant difference from the long run relationship between GDP and traffic growth which is usually based on an elasticity of 1.5-2.5 according to a report from Eurocontrol ("Challenges of growth 2013").

Based on the above we believe that the passenger forecast requires an upward adjustment, taking the elements outlined above and in the appendix into consideration.

Operating Expenditure

Overall, we support the approach and the methodology the CAR has followed by using the SDG report as the main input for the draft determination. It is a balanced approach which highlights the potential for efficiencies and indicates wage level adjustments on a need basis. Although this is broadly transparent, we would still like to raise concerns with regards to the allowed wage increases for IT staff due to skills shortage. With high unemployment rates throughout Europe and a largely mobile labor force, we do not see the general shortages in the supply of skilled IT professionals.

With regards to comparing Dublin airport with other Irish semi-state companies as shown in chart 4.6 on page 25, it is evident that one company's operating costs drive the overall average as stated in 4.36. We would like to understand if and how this significant deviation from the rest has made an impact in the cost determination.

While we see scope for improving the cost base further and setting the cap lower, we fully disagree with the cost development envisaged by DAA as mentioned under 4.44. Cost development needs to be contained and we interpret any demand for increases over 2013 as an illegitimate attempt to set a higher baseline for the next regulatory period.

Commercial Revenue

We support the approach to forecasting commercial revenues however we remain opposed to rolling incentives for commercial revenues. On till exits, we favor the scheme with regards to the proposal to build a Dublin Airport City as detailed on page 33. Should the Dublin Airport City development be executed on land currently owned by the DAA, we would expect an adjustment to the RAB as well as revenue from the sale of land.

Capital Costs

We support the CAR decision not to revise upwards the allowance for Terminal 2 capital expenditure due to cost overruns as these are the result of underperformance. These overruns and any associated changes in scope would have required the consent of the airport's users, which is absent. As a consequence, these costs cannot be claimed by DAA. It is therefore reasonable that the reconciliation of the capital expenditure on Terminal 2 and the reconciliation of the 2010 – 2014 capital expenditure as executed by the CAR results in a disallowance. As a guiding principle an allowance can only be changed if agreement with users has been reached.

For the capital expenditure allowances 2015 – 2019 we are convinced that the trigger to construct a parallel northern runway is not appropriate. While the need for a parallel runway is not in doubt should traffic increase above a certain threshold, we believe that the trigger mechanism should not be linked to passenger numbers. Moreover, before reviewing the need for a new runway or determining a trigger mechanism, a more efficient use of the existing runways needs to be explored.

If then a trigger is decided, a more robust trigger could be tied to:

- The theoretical maximum number of aircraft movements per hour or per 15 minute period;
- A level of acceptable delay being exceeded.

This as runway capacity is more directly linked to aircraft movements than to passenger numbers. In order to define what trigger or combination of triggers are acceptable to all parties, consultation between primary stakeholders will be required.

Disallowed investments

We support the CAR decision on disallowed projects for capital expenditure for the 2015 – 2019 period. In this context and as indicated in our general comments, we are aware of efforts from DAA to influence stakeholders in order to allow more projects into the new determination. IATA has engaged with airlines to define its position towards these projects. The following comments summarize the key messages:

1) The Arrivals and the Façade project in T1 are largely "cosmetic" in nature, i.e. the planned refurbishment does not provide any measurable benefit in terms of capacity enhancement. Under the same measure, the T1 Check-in and Security project as well does not provide any measurable capacity enhancement. It is however the DAA's responsibility to comply with security standards.

2) For T1 Check-in & Security, we support the CAR decision, as this scheme provides no measureable capacity enhancement. We however highlight that it is DAA's responsibility to comply will all current & future security standards.

3) For the Central Search Area it is the firm belief of airlines that new technologies are not required.

4) Pier 3 Flexibility: IATA's view is that proposed expenditure could not be justified, as this would only be a short-term fix, prior to a new pier being required / constructed. Alignment is required following decommissioning of the crosswind runway (and only following extensive consultation and agreement from carriers currently reliant on the crosswind runway).

5) Tied to the discussion on Pier 3 Flexibility is the Airfield Infrastructure for Large Aircraft program. The Pier 3 Flexibility project in part provides for a single Code F stand. Should DAA be required to provide infrastructure to support Code F operations then said infrastructure would require agreement from the airline community through a recognized consultation program.

6) T2 Transfer Facility: An interim solution is currently in place which is acceptable to the airline community. An increase in security lanes from the current 3 lanes to 10 as proposed by DAA is not acceptable.

7) Apron 300R: Remote stand area 5G has been allowed to augment existing and proposed remote bussing operations. Additional remote stands are not required at this stage.

8) Pier 2 Segregation: IATA's view is that proposed expenditure could not be justified, as this would only be a short-term fix, prior to a new pier being required / constructed. Alignment is required following decommissioning of the crosswind runway (and only following extensive consultation and agreement from carriers currently reliant on the crosswind runway).

9) T2 HBS Standard 3: As installation of these machines will fall into next permission period, any deposit required when ordering needs to be covered by DAA. The balance will not be paid until the next determination.

10) Line-up Points to R10-28: This is the last element of a four part plan, with the benefit only quantifiable in years four to five of the determination.

Cost of capital

We note that the point estimate for several parameters of the WACC uses the maximum value of each respective parameter with the minimum value for the gearing. As a consequence, out of the determined range of 3.8% - 5.9% for the pre-tax WACC, the return on capital allowed is calculated at 5.8%. The values for the asset beta and the cost of debt are significantly higher than would be expected based on recent regulatory decisions (LHR) and current market conditions.

With regards to the **cost of debt**, page 63 states that the proposed value is more than 100 basis points lower than the 4.1% used in the 2009 determination. It is evident that the market conditions in 2009 at the height of the financial crisis and today are considerably different. While across the Euro zone interest rates on government bonds have decreased substantially with the Euro area facing deflationary tendencies, we would have expected a lower figure than 3% on cost of debt. In fact, the cost of debt in our view would have been set at the lower end of the range at 2.5%.

For the **asset beta** value, we refer to chart 6.9 on page 63 which shows estimated asset beta ranges for listed airports with values varying between 0.1 and 0.6. The determined range for Dublin is indicated as 0.5 – 0.6. While some utilities may have indeed lower asset betas, chart 6.9 explicitly lists only airports where only two airports (Paris and Frankfurt) reach the 0.6 beta value at the end of the range. Furthermore, recent regulatory decision has determined an asset beta value for LHR of 0.5. With such robust evidence, the asset beta for Dublin airport should be determined at 0.5 as we do not see a risk exposure of DUB justifying an asset beta at the end of the determined range.

We support the proposal for the notional **gearing** rate within the range of 50-60%. However, in line with the recent regulatory decision for LHR airport for a notional gearing at 60%, we are convinced that the 50% gearing rate for DUB is too low. We would ask CAR to consider setting the gearing at a comparable level with LHR.

With regards to the CAR approach to bring forward the **depreciation** in order to smooth the charges development, we are not convinced of the benefit of this approach. Without the depreciation adjustment the charges profile would be significantly different with stronger reductions in the first years, reflecting more correctly economic circumstances.

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APPENDIX A: PASSENGER FORECAST REVIEW - DUBLIN

IATA forecast for number of passenger 2014-2018

- Table 1 provides projections of passenger numbers from the IATA Airline Industry Forecast (AIF) for the international air travel markets for the next 5 years – based on a survey done to the industry's major airlines, civil aviation and airport authorities. Current forecast does not cover 2018 so figures in the table are an extrapolation based the average growth rate projected over 2014-2017. That would translate to a compound annual growth rate of 4.2% over the considered time period.

	2014	2015	2016	2017	2018E
Ireland International	3.2%	4.2%	4.7%	4.6%	4.2%

Table 1. Source: Projections of passenger numbers (IATA Airline Industry Forecast).

- According to ACI Annual Worldwide Airport Traffic Report the share of passengers served at Dublin compared to the rest of the country was over 80% in 2012. Therefore, consider these country level projections as largely reflective of the air travel markets to, from and through Dublin.

Verifying forecast with expectations of GDP growth

- Growth in GDP is a measure that has historically been highly correlated with passenger traffic growth.[1] [2] Comparing forecast flight movements with expected GDP growth can serve as a good reference point for checking the validity of air traffic forecasts. The long run relationship between GDP and traffic growth used in air traffic forecasting is traditionally based on an elasticity of 1.5-2.5.[3]

- Table 2 presents the expected GDP growth rates for international destinations served from Dublin weighted by the number of seats. The average is calculated by averaging the international growth rate with the expected growth rate for the Ireland economy.

	2014	2015	2016	2017	2018
International destinations served	2.2%	2.1%	2.2%	2.1%	2.2%
Ireland	1.7%	2.5%	2.5%	2.5%	2.5%
Average	**1.9%**	**2.3%**	**2.3%**	**2.3%**	**2.4%**

Table 2. Source: GDP forecast (IMF); Seats served (SRS Analyzer).

- Table 3 presents the expected passenger growth rate using the long run relationship between GDP and traffic growth based on a conservative estimate of the median elasticity of 2.0.

	2014	2015	2016	2017	2018
Average	**3.9%**	**4.6%**	**4.7%**	**4.6%**	**4.7%**

Table 3. Source: GDP forecast (IMF); elasticity of traffic growth with GDP (Eurocontrol).

- The above illustrates that the IATA Airline Industry Forecast from 2014-2017 provides a more conservative estimate of flight movements compared to what would be expected from applying the historic relationships between GDP and air traffic growth to IMF GDP forecasts. The two approaches yield consistent results, with the IATA Airline Industry Forecasts providing a more conservative measure of expected passenger growth.

[1] http://www.iata.org/whatwedo/Documents/economics/IATA_Economics_Briefing_Impact_of_Recession_Dec08.pdf
[2] http://www.boeing.com/assets/images/commercial/cmo/images/cmo_methodology_chart3_lrg.gif
[3] http://www.eurocontrol.int/sites/default/files/content/documents/official-documents/reports/201211-challenges-of-growth-2013-task-3.pdf

Drawbacks of forecast presented in consultation document

- The approach for forecasting passenger growth proposed in the consultation document raises several concerns. The overreliance on one input variable (GDP growth) as a basis for undertaking the passenger forecast points to over reliance on one method.

- Passenger numbers will be impacted by supply side and demand side effects. Focusing only on GDP as the basis for forecasting passenger numbers ignores supply side factors, which may have significant impacts as was likely the case in 2006/7 with the entry of Ryanair. Even on the demand side, GDP may not be the best variable to reflect travel demand. If GDP growth is used as basis for estimating passenger numbers, it should be in conjunction with other approaches such as surveys.

- The consultation document indicates that changes in Irish GDP will prompt a change in passenger numbers by 1.15 times. This indicates a significant difference from the long run relationship between GDP and traffic growth, the difference is likely to be explained by several shortcoming of the analysis presented in the consultation document. When trying to identify the relationship between GDP and passenger growth, doing so by focusing only on the country where the airport is domiciled is not appropriate. The growth profile of GDP of other countries will also impact the number of travelers.

- Furthermore, without information on the r-square we don't know the extent to which the trend in GDP over the considered time period fits the trend in passenger growth. However, even if analysis has a high r-squared (closer to 1) it may still be the case that the relationship observed is distorted due to omitted variables. For example, an improvement in income equality in a country can have a positive impact on air travel without a commensurate impact on GDP growth.

- It is IATA's view that the passenger forecast presented on pages 13-17 of commission paper 1/2014 should not be used as basis for projecting passenger growth at Dublin airport.

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IATA Economics