

Fly Free? The onset of ultra-low cost service brings new questions for small airports.

By Matt Seitz

In May Skybus, the first ultra-low-cost carrier in the U.S., announced service from its base of operations at Port Columbus International Airport to eight destinations nationwide. Included in this first wave of destinations are Portsmouth, N.H. (serving greater Boston), Fort Lauderdale, Fla.; Greensboro, N.C.; Kansas City; Burbank (serving greater Los Angeles); Richmond, Va.; Oakland, and Bellingham, Wash. (the Seattle/Vancouver area). The carrier plans to offer at least 10 \$10 tickets on every leg it operates. Providing some heft behind its business plan is some \$160 million in start-up capital, provided by the likes of Fidelity, Nationwide Insurance, and Morgan Stanley.

Somewhat conspicuous on the list of destinations are non-hub airports in Bellingham and, especially, Portsmouth International Airport at Pease (PSM). How does an airport with barely 17,000 enplanements in 2006 attract one of the best-capitalized low-cost startups in years? The answer: relatively close proximity to

a major market (Boston is 55 miles away), and the waiving of all airline fees for two years. "We signed a two-year agreement to allow them (Skybus) to do business here, essentially without any fees," Pease Development Authority Executive Director Dick Green told the Seacoast Online. "It's kind of a 'loss leader.'"

'Free Lunch' Economics

Portsmouth's decision to allow Skybus to fly for free begs the question: how far should small and non-hub airports, struggling to attract coveted low-fare service, be willing to go?

It is not uncommon for airports to offer incentives, especially to low-fare airlines, in order to entice them to serve their airport over other options. However, the complete lack of terminal rent or landing fee income for two years would have small airport officials asking, "What's in it for me?" Is it possible for the airport to recoup its investment through other sources of revenue? Or is it, as Green put it, "a loss leader," contingent

upon the airport being able to broker a better deal in a couple of years?

Although Skybus will begin with a relatively modest amount of service, its 65 planes scheduled for delivery by late 2008 mean that many other small airport operators may be asking themselves the same question in the coming months.

So what's a small airport to do? Here we examine three hypothetical scenarios of what might transpire if you, a small airport operator, succeed in luring a low-fare carrier to your airport.

The Good

Let's assume that a start-up low fare airline such as Skybus begins service with two flights per day to your airport. The carrier achieves strong load factors of about 75 percent on the route. Your airport agrees to waive all landing fees, terminal rents, and apron charges for two years, forgoing revenue of approximately \$5.60 per enplaned passenger, the average cost airlines paid non-hub airports in 2005 (See figure 1). On the plus side,

Fig.1

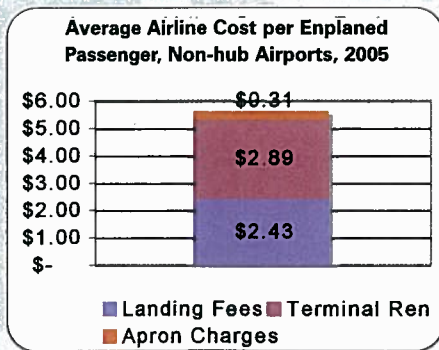


Fig.2

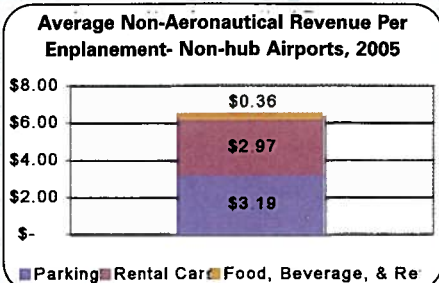


Fig.3

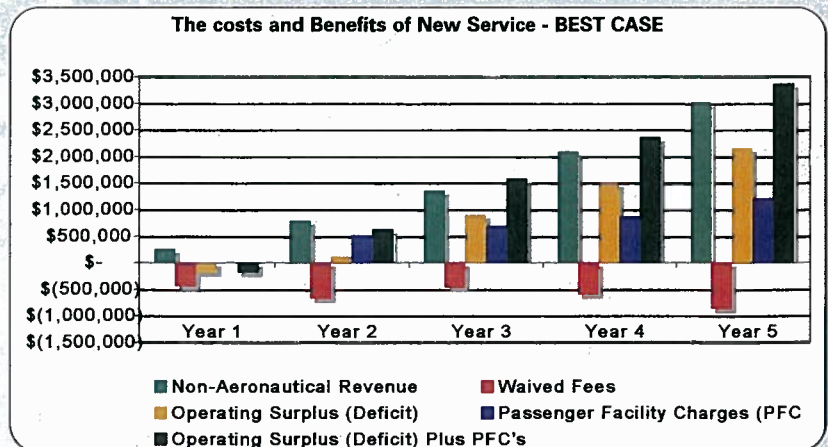


Fig.4

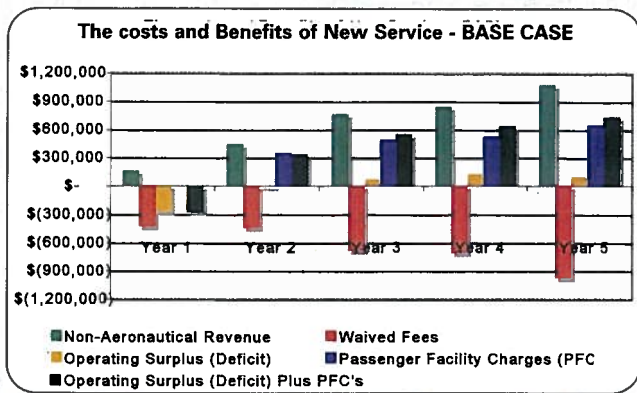
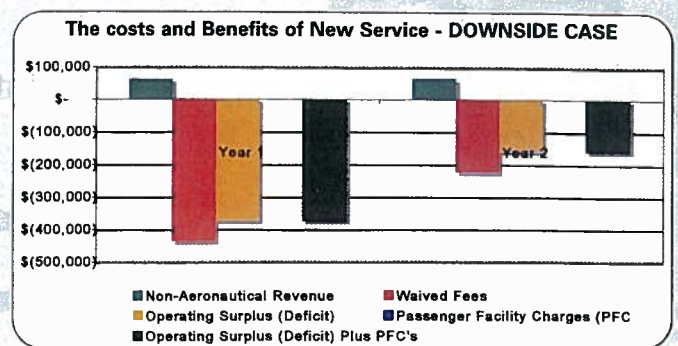


Fig.5



you average about \$3 per enplaned passenger in non-aeronautical revenues from rental cars, parking and retail, roughly half the average that non-hubs achieved in 2005 (See figure 2). All told, the fee income you waived is about \$200,000 greater than the additional revenue your airport earns serving 85,000 new passengers in year one.

In year two, your carrier adds an additional daily flight, and the airport brings in \$6 per enplaned passenger—the non-hub average—from rental cars, parking and retail. This additional revenue outstrips the fees you agreed to waive by about \$100,000. Your airport applies to the FAA to charge a \$4.50 passenger facility charge (PFC), and begins collecting it in this second year of operations, accumulating approximately \$500,000 for capital upgrades from the roughly 125,000 enplaned passengers. At the end of year two, your airport re-negotiates with Skybus, and they agree to pay half of the average airline cost per enplanement for non-hubs beginning in year three.

Your carrier continues to expand rapidly. The airline adds one additional departure from your airport in each of the next two years and two more in year five, for a total of seven per day. By this fifth year, the airport is bringing in \$9 per enplaned passenger from rental cars, parking and retail. (While this is a lofty goal, it is similar to what non-hub Roanoke achieved in 2005.)

Under these circumstances, 300,000 enplaned passengers would generate a surplus of approximately \$2 million over the discount afforded

to the carrier. The airport would also be generating approximately \$1.25 million annually in PFC revenue, helping to fund expansion. Your start-up carrier is firmly entrenched as a mainstay amongst U.S. carriers. Your airport has been transformed from a struggling non-hub to the verge of achieving small-hub status. (See figure 3.)

The Not-As Good (But Not Bad)

As in the best-case scenario, your new carrier begins service with two daily flights. As Portsmouth did, you waive all fees for two years. You even agree to throw in six months of free parking for passengers. Waving the fees costs you about \$450,000 in the first year. In exchange your airport sees an additional 80,000 passengers. Generating approximately \$2 in retail, rental car and parking (for the six months you do charge) per enplanement offsets roughly \$160,000 of this foregone income, for a deficit of about \$290,000 that first year.

In year two, the airport generates \$5 per enplaned passenger in non-aeronautical revenue resulting in a break-even scenario when compared to the waived fee income. FAA approves a PFC. You are left with about \$400,000 in PFC revenues that can be used for eligible airport upgrades.

After two years, you sit down with your carrier and are informed that they would love to continue to serve your airport, but simply cannot afford to pay any fees without jeopardizing their low fares. Grudgingly, you agree, knowing that finding a replacement carrier would not be easy.

The airline does add a third daily flight in year three and a fourth in year five. By the fifth year your airport is generating \$6 per enplanement in non-aeronautical revenues from retail, rental cars and parking—roughly the non-hub average. This additional income now covers the fees you agreed to waive, but just barely, by about \$90,000 per year. In addition, the airport is now seeing approximately \$700,000 per year in PFC revenue, making it easier to catch up on sorely needed improvements.

Your airport is now serving 160,000 new passengers, who appreciate their low fares, timely service and convenience. You are left with a viable flagship carrier and a success story to pitch to prospective new airlines. (See figure 4.)

The Ugly

Desperate to bring in some service after the departure of a bankrupt legacy carrier, you offer a start-up carrier two years of operations for free, and are backed into offering free parking for a year. The new airline kicks off with two daily flights. However, passengers find their no-frills approach simply too uncomfortable, even at bargain-basement prices. Flights are often cancelled or late. Load factors average 55 percent in their first year, and your airport struggles to generate \$1 per each of its 60,000 enplaned passengers in additional revenue since it cannot charge for parking. Foregone fee income outstrips new revenues by \$375,000.

In the second year, your carrier has to cut back service to one flight per

up front

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day. However, load factors do not improve, with the airline continuing to fly planes that are only half full. Despite your hard work, your small airport cannot seem to generate more than \$2 per enplaned passenger in revenue from parking, retail, and rental cars. FAA rejects your PFC application.

After two years, the new carrier finally has to follow the likes of other low-fare start-ups into bankruptcy, ceasing all service to your airport. All told, you have given up \$500,000 more in fees over two years than you have generated in non-aeronautical revenue. (See figure 5.)


Lessons Learned

So, should small airports waive fees to attract service? As the results show, it depends. As an airport operator, you know the market conditions in your region and have the best idea of how much your airport might be able to generate in non-aeronautical revenue. Under the best of outcomes, your airport shells out some up-front cash, but in a couple of years, renegotiates a better deal and generates

enough in landside revenue to generate a surplus, while your airport is completely transformed. The most likely outcome says your airport should not bank on brokering a better deal in two years, but it is feasible that revenues from parking, rental cars and retail will at least equal the fees you eschew.

Although there is no clear strategy for dealing with a low-fare carrier, perhaps the most important negotiating tactic as an airport operator is to keep an open mind. Waiving fees may not seem like an optimal solution to any airport, but keep in mind that it is within the realm of possibility that additional revenues from other sources could cover most, if not all, of the discount. Don't forget to factor PFC revenues into the equation. If possible, work towards a deal that gives a new carrier a discount in its early years of operations in exchange for allowing the airport to share in its success in the long run. Think about getting creative and tying airline fees to benchmarks based on number of passengers served or the airline's profitability.

A small communities grant or similar assistance would be of great help in offering those early discounts.

Having difficulty determining the long-term staying power of a start-up airline before spending those hard earned grant dollars? Although there are no guarantees, the best indicator is likely to be the size of the airline's capital reserves. JetBlue raised \$140 million before starting operations in 1999, and has gone on to become a top-10 carrier in terms of U.S. market share. It's impossible to know if a start-up carrier is destined for fame or failure, but airports in Portsmouth and Bellingham have 160 million reasons to believe Skybus will be around awhile. 

How does this experience compare to your airport? If you would like to share your ideas and information, please e-mail Matt Seitz at MSeitz@IMGGroup.com.

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The Millington Airport Authority

is requesting proposals from commercial aeronautical service providers to provide one or more of the following at the Millington Regional Jetport:

- Air charter
- Tour Operators
- Aircraft Maintenance
- Parts/Pilot Supply
- and other aviation related services. A 50,000 sf maintenance hangar and additional office/retail space is available.



Responses must be received no later than **September 11 by 4:00 p.m.** at 8182 Hornet Avenue, Millington, TN 38053. For more information visit www.knqa.com or contact Tracy Williams at (901) 873-5792.