AIRPORT DEVELOPMENT AND PUBLIC PRIVATE PARTNERSHIPS

CONFERENCE REPORT
1ST ANNUAL ACI-WORLD BANK AVIATION SYMPOSIUM & 7TH ANNUAL AIRPORT ECONOMICS & FINANCE CONFERENCE
25-27 FEBRUARY 2015 | LONDON, UNITED KINGDOM
WHAT’S INSIDE?

This white paper summarizes discussions that took place at the ACI-World Bank Aviation Symposium (25 February 2015) and the 7th Airport Economics & Finance Conference (26-27 February 2015) in London, United Kingdom. It is generally limited to the information that was presented and any associated discussions during the panel sessions.

ACI-WORLD BANK AVIATION SYMPOSIUM
25 FEBRUARY 2015

WELCOME FROM THE ORGANIZERS PAGE 4

SESSION ONE: PUBLIC-PRIVATE PARTNERSHIPS (PPPs) IN AIR TRANSPORTATION PAGE 5

SESSION TWO: PPPs AND THE FINANCIAL INVESTORS PAGE 10

KEYNOTE ADDRESS: MUNEER FEROZIE, IFC PAGE 13

SESSION THREE: PPP AIRPORT CANDIDATES PRESENT THEIR CASES PAGE 15

SESSION FOUR: WORLD BANK BOOK PRESENTATION “READY FOR TAKE-OFF” PAGE 20

AIRPORT ECONOMICS & FINANCE CONFERENCE
26-27 FEBRUARY 2015

CHAIRMAN WELCOME PAGE 24

KEYNOTE ADDRESS PAGE 24

SESSION ONE: STATE OF THE INDUSTRY PAGE 26

KEYNOTE SPEAKER: MICHAEL MCGHEE, GLOBAL INFRASTRUCTURE PARTNERS PAGE 30

SESSION TWO: FUTURE STRUCTURE OF THE AIRLINE INDUSTRY PAGE 31

SESSION THREE: REGULATORY FRAMEWORKS - BEST PRACTICE AND NEW THINKING PAGE 32

SESSION FOUR: MANAGING RISK PAGE 35

SESSION FIVE: AIRPORT PERFORMANCE MANAGEMENT PAGE 36

SESSION SIX: AVIATION - THE ECONOMIC MULTIPLIER PAGE 38

SESSION SEVEN: SUPERCHARGING NON-AERONAUTICAL REVENUE STREAMS PAGE 41

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<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACI</td>
<td>Airports Council International</td>
</tr>
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<td>ACSA</td>
<td>Airports Company South Africa</td>
</tr>
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<td>AFR</td>
<td>Africa Region</td>
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<td>ANAC</td>
<td>National Civil Aviation Agency of Brazil</td>
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<td>ANSP</td>
<td>Air Navigation Service Provider</td>
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</tr>
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<td>DINAC</td>
<td>Civil Aviation Authority of Paraguay</td>
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<tr>
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REPORT HIGHLIGHTS

PUBLIC PRIVATE PARTNERSHIPS (PPPs)

- The business model of airports has fundamentally changed. Airports have moved away from being mere infrastructure providers to full-fledged and diversified businesses.
- To be financially viable, the assessed risks need to be allocated appropriately to the party best able to bear it and obligations need to be clearly defined upfront.
- Investors are attracted to realistic market projections including commercial opportunities, a transparent tender process, realistic and flexible design, a sponsor with strong management, financial, technical capacity, and compliance with E&S.
- Strong political support including buy-in from the government and public are critical to ensuring the success of a PPP.
- Significant untapped potential exists in emerging markets. However, challenges remain including weak government capacity, diverging government interests, regulatory instability, and excessive costs.

STATE OF THE INDUSTRY

- Airports are an important economic source in the broader economy, generating multiplier effects through tourism, trade, etc.
- The Middle East and Asia Pacific continue to record the strongest passenger growth among the regions, while Europe is showing signs of a recovery.
- The move to revenue diversification has been critical to the financial resilience of airports. However, most airports are small and do not cover their full costs.
- Regulation should reflect the airport’s degree of market power relative to competitive alternatives.
- A common theme is the need for effective partnership, for example between ANSP and airports on ATM, and airports and airlines on non-aeronautical activities.

THE FUTURE STRUCTURE OF THE INDUSTRY

- The focus in aviation has shifted to affordability. Travel is becoming more democratized (e.g., as reflected in the rise of LCCs).
- Emerging markets are expected to drive demand as income improves.
- There are concerns over capacity constraints. But some aviation assets continue to be underutilized around the world (e.g., regional airports).
- Many of these dimensions are pointing towards a more demand-oriented operating environment and a greater focus on the customer.
- The key steps forward will require enhanced aircraft efficiency, operational efficiency, manufacturing efficiency, and greater use of technology and data.

REGULATORY FRAMEWORKS

- The lack of a competitive market warrants effective regulation: to protect the interests of users, to ensure the right incentives are in place, and quality services are provided.
- The industry suffers from a fragmented and inconsistent regulatory approach and governments need to strive towards greater consistency.
- Effective/smart regulation should not crowd out any commercial solutions that might be beneficial to users.
- Airports and airlines need to realize their mutual interests in making sure effective and efficient capacity is available at airports.

MANAGING RISK

- In terms of risk assessment, airports compare favorably to other infrastructure sectors.
- Risks need to be adequately assessed to ensure a bankable transaction.
- Positive factors include the potential for revenue growth, and diversification.
- However airline fragility, exposure to competition, and discretionary spending are negative factors.
- Stakeholder value can be enhanced through appropriate risk mitigation measures that cover financial, strategic, and operational activities.

PERFORMANCE MANAGEMENT

- PM is an essential part of optimal and informed decision making and is increasingly being transformed with the help of technology and data.
- There is a diversity in PM frameworks and implementation.
- A solid PM should be multi-perspective and focused, linked to strategy and measurable with KPIs.

THE ECONOMIC MULTIPLIER

- Aviation can have direct, indirect, induced, and catalytic impacts on the economy.
- However it remains difficult to capture the endogenous nature of aviation given that it drives and is driven by economic growth.
- There is a greater need to align policymaking with the recognized value of aviation (e.g., through effective advocacy and communications).

NON-AERONAUTICAL REVENUE STREAMS

- Airport business models are evolving, driven by privatization, downward pressure on aeronautical revenues, and the need to finance infrastructure.
- Retailers are finding new ways to better engage customers and drive consumption.
- More collaboration is still needed between retailers, airlines and airports.
WELCOME FROM THE ORGANIZERS
Dr. Charles Schlumberger, Lead Air Transport Specialist, World Bank (Chairman and Moderator)
Dr. Rafael Echevarne, Director of Economics and Program Development, ACI World

This year marked the first joint initiative between Airports Council International (ACI) and the World Bank. For the World Bank, this is the 11th year it has collaborated with the industry to hold an aviation conference. The overall objective was to take stock of developments to assist the Bank’s efforts to develop the air transport sector, exchange knowledge, and learn about developments in the industry. This year’s focus was on Private Public Partnerships (PPPs) in airports.

Charles Schlumberger, Lead Air Transport Specialist of the World Bank opened the summit with the notion that PPPs are not new. In fact, there is a long history of PPPs beginning as early as 1438 when a French nobleman was granted a river concession to charge fees for goods transported on the Rhine. However today we operate in a more sophisticated environment with complex regulatory, finance, political and technical issues at play.

The audience’s existing knowledge on PPPs was tested with the help of an electronic voting system. Most participants [44%] thought that out of the world’s 3,000 commercial airports, 30% have some sort of private participation. Today, 74% of all airports are public and handle 58% of all passengers. Approximately 19% of airports in the world are PPPs, accounting for 30% of total passengers. In fact, only 8% of airports are private airports, and handle 12% of passengers.

The second question revealed that the overwhelming majority of participants were convinced that PPPs offer numerous benefits. More than 75% of delegates voted that raising capital, better management (operations), and results (profitability) are all important advantages of PPP arrangements.

In terms of challenges, the audience felt that convincing the (public) owner to undertake a PPP remains the primary challenge of establishing airport PPPs [54.2%], followed by dealing with unions [16.9%], raising capital [15.3%] and convincing users [13.6%].

Opinions were mixed on the risks for an owner in a PPP transaction. Over one-third of participants [36.1%] voted insufficient traffic as the primary risk, followed by private investor defaults [27.9%], resistance by users [26.2%], and PPP contract too long in duration/not profitable [9.8%].

Approximately 19% of airports in the world are PPPs.

...the audience felt that convincing the (public) owner to undertake a PPP is the primary challenge.

According to the majority of symposium participants [48.3%], the most important due diligence work when preparing a PPP is concerning the regulatory framework (including tariffs), followed by financial analysis [21.7%], consultations with users [16.7%], and legal structure [13.3%]. The audience poll also revealed that most delegates [41.7%] felt that technical advisors/consultants are the most difficult to find, compared to financial advisors [26.7%], and legal counsel [16.7%].

The symposium was designed to address many of these issues and concerns. The first session explored the fundamentals of PPPs. The second assessed the risks and opportunities associated with PPP transactions. The third session gave airport candidates an opportunity to present their PPP cases to potential investors. The last session consisted of a book presentation and panel discussion on Low-Cost
Carriers which was recently published by The World Bank.

Rafael Echevarne, Director of Economics and Program Development at ACI World urged participants to actively engage in the discussions. He also reminded delegates to take advantage of the services available including ACI’s APEX in Safety, APEX in Business, and other training courses. ACI will be joining forces with the World Bank to help bring these initiatives around the world, with the aim of raising the quality of airport management and ensuring safe operations.

SESSION ONE: PUBLIC-PRIVATE PARTNERSHIPS (PPPs) IN AIR TRANSPORTATION

Review of the fundamentals of PPPs: financial and legal structure of typical PPPs in air transportation (airports, ANSPs); the role of the regulator in PPPs, risk and opportunities.

Keigan Cox, General Manager and Chief Executive Officer, Saint Lucia Air & Sea Ports Authority
Andrew Harrison, Managing Director, Manchester Airport Group, Corporate Development Director, Manchester Airport Group
Muneer Ferozie, Regional Manager, MENA PPPs and Privatization Financial Advisory, IFC
Michelle Ottey, Investment Officer, (Head of Advisory Services, Caribbean), IFC
Eliot Lees, Vice President, ICF International

Saint Lucia’s Growth Potential

Tourism is the primary sector for small island economies such as Saint Lucia. Keigan Cox of Saint Lucia Air and Sea Ports Authority (SLASPA) opened the session with a presentation on the country’s first formal PPP in the making - Hewanorra International Airport. With a GDP of US$1.33 billion and US$8,000 per capita, a land area of 611 km², and a population of around 166,000 people, the country has a lot to gain from this opportunity.

In terms of air traffic, the country recorded a total of 34,657 aircraft movements in FY2014 from the country’s two airports, Hewanorra International Airport (HIA) and George F.L. Charles Airport (GFL). Located in the south of the island, HIA is also the main gateway to the country and recorded 690,000 passengers this year. 277,000 passengers were recorded at the smaller regional GFL airport located in the north of the island. Hewanorra offers a mix of passengers, 75% of all passengers are foreign passengers at HIA. The primary market is the US, followed by Europe and Canada. A 30-year passenger forecast estimates 1.6 billion passengers by 2044 (see chart).

Following a policy decision by the government, Saint Lucia is pursuing Hewanorra as a PPP opportunity through a long-term concession to operate and maintain the airport’s existing facilities and design, build, finance, operate and maintain new facilities. A 30-year master plan was just completed to support the expansion. IFC is supporting SLASPA on the transaction to help ensure the development takes place in a transparent manner and in accordance with international standards, to attract the optimal investment for the country.

The estimated capital investment would be US$207 million, with US$125 million in the initial phase (2016-2030). $54.6 million would be devoted for the terminal. Cox highlighted the importance of flexibility in structuring the transaction. A phased CAPEX approach was chosen for flexibility, and to allow further expansion when operational cash flows would be sufficient (i.e., less pressure on charges).

A major challenge for PPPs is to obtain government/owners buy-in; fortunately this proposed transaction has the full support of the
current government. This will help ensure a supportive political framework and governance for the project, said Cox. In addition, there is strong support from the public as citizens remain eager to see the development of the airport.

This would be the first formal PPP decision in the Caribbean. The issuance of the Request for Proposals is expected in early May 2015. The commercial closing is targeted for November 2015 and the financial closing for June 2016. As expected, there will be a lot of learning involved, but it also presents a significant opportunity for the island economy.

Success at Stansted

Andrew Harrison outlined a unique example of a PPP in action through the Manchester Airport Group (MAG). He highlighted the long-term viability of the model, which culminated in the successful acquisition and integration of Stansted Airport in 2013.

MAG has a unique governance and voting structure whereby the public sector (the Greater Manchester Borough and Councils and the Council of the City of Manchester) make up 64% of ownership, while the remaining 35.5% is from the private sector (IFM).

However, from a voting point of view, it is balanced between public and private as decision making powers are split evenly between Manchester City Council and IFM (the two major stakeholders), while MAG continues to meet the requirement to designate it as a private company.

Harrison described that it helped to have “enlightened public sector owners”; with a commercial mindset, that were able to see the potential of the airport to be a source for economic growth.

The acquisition of Stansted entailed a lengthy and complex two stage process. The first step involved attracting investment into MAG. Second, the investment would only vest if they were successful in acquiring Stansted (and growing the overall “pie” of the business). The other challenging aspect was to ensure that public sector partners were satisfied and able to justify it to their constituents.

IFM investors were brought in as MAG’s preferred partner. Harrison described the strong compatibility with IFM. They had shared goals: long term partnership, sustainable growth, and a focus on excellent service. In addition, IFM already had experience in the sector (through ownership in the airports sector in Australia), and were able to add significant value to MAG’s business and Stansted. MAG beat three other competitors to acquire Stansted in February 2013.

The first priority was to get the airport back on a path to rapid growth. This has been underpinned by long-term commercial agreements with airlines to drive increased frequencies, additional capacity and new routes, and to incentivize growth. For example, the agreement with Ryanair has contributed to a greater focus on costs. The airline will increase passengers by more than 35% over the next 5 years and up to 50% over the next 10 years.

The project is also helping transform the passenger experience and drive up commercial yields. Investments are being made in new security areas, retail space, and other terminal developments. The positive results are already starting to show. Stansted is now the fastest growing major airport in the UK. The airport recorded passenger growth of 29% in January 2015 vis-à-vis a year earlier.

An Evolving Business Model

Muneer Ferozie of the International Finance Corporation (IFC) shared some insights on the important considerations in structuring a PPP, including the important roles played by both public
and private sectors, drawing from IFC’s global advisory experience.

Private sector involvement can result in better service provision (for example on O&M, whereby risks related to operations and maintenance can be transferred to the private sector with clear Key Performance Indicators (KPIs) and performance incentives in place). In addition, the public sector can greatly benefit from the introduction of operational efficiencies, new revenue streams, and international best practices. The business model of airports has fundamentally changed.

PPP arrangements allow asset transfer so that airports and related developments return to private sector ownership at the end of the concession. Private sector involvement also facilitates financing and mobilization of capital markets in a much more efficient way.

For a successful partnership, the private sector must also have an interest. As Ferozie explained, airports are now a different asset class than they used to be. Traffic continues to grow all over the world with strong demand forecast in certain regions, aided by the drop in oil prices. Airports generate substantial revenues in hard currency, which carries low foreign exchange rate risk.

PPPs come in many forms with different allocation of responsibilities. It can range from basic technical assistance to full divestiture. In between, there are a variety of management contracts (see chart). As you move from technical assistance and service/management contracts towards a full divestiture model, contract duration and risk to the private sector increases and the involvement of the public sector declines (e.g., in full divestiture, the government serves as more of a regulator).

Airports have moved away from being mere infrastructure providers to full-fledged and diversified businesses.

Airports have moved away from being mere infrastructure providers to full-fledged and diversified businesses.
There are also opportunities to develop real estate, commercial, and auxiliary activities outside the perimeter of the terminal (e.g., airport cities). Traditionally, airports were publicly owned and often used to secure the needs of flag carriers. Now, they operate in a highly competitive environment and seek to cater customers with different needs.

**Key Success Factors**

Michelle Ottey of IFC described the key success factors from the perspective of a transaction advisor. The role of a transaction advisor is to identify what needs to be done for the transaction to take place successfully. Project preparation should cover technical, legal, financial, and environmental and social (E&S) aspects to properly assess risks, develop a market based structure, and attract investor interest.

IFC provides comprehensive transaction advisory support in two phases: Phase 1 covers due diligence which identifies objectives and strategic options, and informs transaction structuring, ultimately preparing the transaction for the market. Phase 2 involves working with governments, marketing to investors, and developing the bid process up to closing.

The legal and institutional framework needs to be reviewed, including understanding the legal/contractual obligations, and potential litigation (if any). Financial diligence entails developing a financial model and analyzing the financial sustainability. E&S preparation involves identifying any existing E&S issues and suitable remediation or mitigation measures that need to be put in place.

After due diligence, another important element is structuring the transaction, which takes into account financial sustainability (revenue and traffic potential should justify expected level of investment), user fees (within acceptable levels), and adequate public sector payment capacity for financial obligations including termination payments, guarantees/subsidies (as needed).

Ottey described that in a PPP there are actually three parties that need to be satisfied: the government, the private sector, and the lenders. For it to be a bankable deal, the assessed risks need to be allocated appropriately to the party best able to bear them. For example, commercial risk typically should remain with the private sector while regulatory risk should remain with the government. In addition, the structure should facilitate access to private financial markets on suitable terms and conditions.

The legal and regulatory framework is also critical for the transaction. There needs to be separation of the technical regulation from policy. In some countries, there is a supporting PPP legislation or policy framework. If there is no regulation, relationships and responsibilities should be addressed contractually.

There also needs to be clarity on the contractual provisions including obligations, contributions, and guarantees. The performance obligations also need to be outlined clearly so the private sector knows exactly what to expect (and the penalties applied if they are not met). Strategies to deal with any unknowns (e.g., force majeure) and dispute resolution mechanisms also need to be outlined at the beginning.

Underpinning all of this is a fair, transparent, and competitive process, particularly during the tender phase and post award as this will influence the quality and level of bids and the overall competition.

Ottey highlighted the importance of prequalification, and setting the appropriate selection criteria to increase market interest, reduce the risk of unqualified bidders, and raise the quality of bids.

For the public partner, strong support and commitment by the relevant public authority is critical (which includes understanding the stakeholders and champions). Ottey recalled that of the transactions that have failed, almost 90% of them has been because there was insufficient political support.
Moreover, there needs to be a competent project team or unit to manage the process. Public counterparts need to have the capacity to understand the issues and be able to make decisions over the long term.

Lastly, it is important to see to it that the concept of partnership is fully established in the contractual framework to ensure both parties have “skin in the game”. There needs to be clarity on what the public and private functions are. It is vital to ensure a balanced partnership; it is not a matter of who wins or loses.

Lessons Learned

Eliot Lees’ presentation identified the factors that have contributed to success or failure in a PPP transaction. Based on past cases, what should governments and relevant stakeholders be doing?

At the onset of a transaction, some of the key challenges identified include a lack of a definitive and precise selection criteria, unresolved design issues, and a lack of credibility of the operator. In other cases, there were no negotiations or discussions held with the airlines. The lesson is that the process (including criteria, risks, and responsibilities) needs to be very clearly defined upfront through a consultative process.

Lees also cautioned that these tender processes cannot be done in an accelerated manner. As past instances have shown, rushed tenders have resulted in mistakes and embedded inefficiencies, and often this is only realized after the transaction has closed.

A fine balance needs to be struck. For example, a defined minimum technical requirement (MTR) needs to be set without stifling creativity (e.g., a very specific design can remove the incentive for the private sector to find potential cost savings). Before beginning the tender, it is important to define the priorities (e.g., simplicity vs. low cost vs. creative design).

International organizations such as the IFC can play an important role by bringing a degree of honesty and objectivity to the process, particularly as governments can often get consumed by political issues. Although such transactions can take longer than anticipated, they tend to be more deliberate and focused.

...it is important to ensure the concept of partnership is fully established in the contractual framework...to ensure both parties have “skin in the game”.

For example, the case of Madinah Airport in Saudi Arabia had a clear and transparent selection process and criteria (with the help of IFC). For Madinah, the tender MTR was able to foster design creativity among the bidders; the shortlist resulted in four very different designs.

And finally, successful cases are those which provide financial transparency for bidders with an appropriate balancing of risk and reward. Lees advised that for a successful transaction to take place, governments need to have a defined vision, be transparent, and be realistic.

Managing Expectations

During the discussion following the presentations, Angela Giddens added that a very important constituency is the public, and that managing these expectations is important.

Rigas Doganis commented that very little was said about another set of stakeholders, the airlines, and what they need or want in terms of the PPP. One of the dangers that arise is overbuilding. As a consequence, charges go up and demand can be choked off.

Referring to the case of Stansted, Harrison said that they have sought to shape their value proposition around the airlines by building facilities that they want (e.g., low-cost facilities for Ryanair). Harrison...
stressed the importance of consulting with the airlines to determine what they want and how to create value for them.

Moreover, there are different types of customers to cater for (low cost, premium). Terminal facilities should reflect passenger needs and have the right blend that reflects demand. Bashir commented on the Malaysian experience where they built a terminal specifically for an airline but the public did not like it.

Cox added that from the experience of conducting due diligence in Saint Lucia, investment needs to be phased and modular, driven by demand and not by perceived needs. “In the Caribbean, the general perception is that the bigger the airport, the fancier the terminal, the more you have achieved. That is not the model we have adopted with the IFC – we have taken a more realistic and grounded approach in designing a modular transaction and design.”

SESSION TWO: PPPs AND THE FINANCIAL INVESTORS

Basic financials of PPPs in air transportation; financial models with risk and return; what banks like/dislike in airport PPPs and how risk can be mitigated.

Unathi Mntonintshi, Chairperson, Regulating Committee for Airports Company South Africa (ACSA) and Air Traffic Navigation Services (ATNS)

Doramas Jorge-Calderon, Senior Economist, European Investment Bank

Andy Carlisle, Managing Director EMEA Aviation, LeighFisher

Mark Barges, Solicitor, Linklaters

Ian Twinn, Manager - Global Transport, IFC

Regulating PPPs

Unathi Mntonintshi is the head of the committee that regulates Airports Company South Africa (ACSA) and Air Traffic Navigation Services (ATNS). The regulatory committee ensures that the company pays its financial obligations and has a prospect of earning a commercial return. The system is designed to avoid “super profits”. Given that the companies operate essentially as monopolies, the committee seeks to recreate market conditions.

Both ACSA and ATNS have good political standing and are historically perceived to be performing well. This has made it all the more important to make a strong case for private sector investment. Mntonintshi underscored the importance (from the airport’s perspective) of demonstrating where the system is weak and what the investor is going to provide that is not already there.

Aligning Finance and Utility

Doramas Jorge-Calderon of the European Investment Bank (EIB) addressed the importance of aligning finance and utility in PPPs. PPPs are an evolving model and the evolution can present a challenge for organizations such as EIB. It requires consideration of how best to align financial terms and conditions from a development and infrastructure point of view.

Traditional thinking on PPPs revolved around how to introduce private sector management to operations that were not viable – and this essentially segregated activities according to risk. If, on the other hand an airport was financially viable to begin with, the thinking was you do not require a PPP. The PPP model is now being applied to facilities that are financially viable in their own right.

The new reality is that PPPs can be an alternative model of privatization with minimal financial or risk-taking support by the public sector. The question Calderon posed was: How can a balance on financial considerations be achieved between both private and public sectors?

The first model is the airport PPP as privatization. From a financial perspective, it focuses on how to maximize the dollar for public accounts. Therefore one of the most important criteria for selecting the winning bidder is maximizing the concession fee. There is also a stronger case to be made for a long concession period, as it follows “master plan” rather than standalone “project” thinking.
The lender is likely to be a long-term partner of the concessionaire and pricing would reflect this. In theory, the state is less exposed to financial risk. In addition, pricing can also reflect the type of transaction (e.g., selling several airports together/the Mexican model) versus one-off transactions. From a utility dimension, this model requires benchmarking to other similar airports (e.g., on aeronautical charges). It also makes a stronger case for double-till regulation.

The second model is PPP as introducing private sector management. From a financial dimension, it minimizes the public sector financial contribution. On the other hand, it follows more a “project thinking” approach rather than “master plan thinking”, with shorter concession periods if possible. The lender is seen, for the most part, as a project-finance partner.

There is a greater role in this model for the state as a guarantor, and therefore they carry greater sovereign risk. According to Calderon, it is here that perhaps there is a greater role for development financial institutions for financing. The case for benchmarking still remains. There is a stronger case for single-till regulation and the project may require public financial support.

**Evaluating, Mitigating, and Managing Risk**

Different privatization models have different motivations; however there are some common threads across them in terms of mitigating risk. Andy Carlisle of Leigh Fisher presented an approach to managing risk from an advisor’s perspective.

Evaluating traffic risk is fundamental. For example, asking questions like: Is the demand at the airport based on economic fundamentals and competition, rather than a short-term view on airline and growth prospects? Factors such as catchment, competition, and airline dependency are important to consider for an investor, lender and vendor.

Carlisle also pointed out the interdependency of many factors. This was seen in the example in Portugal when they were trying to privatize the airline at the same time as the airport PPP transaction (whereby traffic would be highly dependent on the airline strategy).

There are a number of obligations that come with a PPP. For example, upholding a level of service and striking a balance between risk and reward. This is often difficult to achieve, as seen in the case of Delhi’s Terminal 3, which resulted in high quality but an overbuilt airport and high charges.

Airports can often offer mitigating opportunities - such as a number of commercial opportunities including property development, retail, parking and cost efficiencies.

It is essential to proactively manage risk by assessing consumer, political, regulatory issues. Carlisle also emphasized the need for flexibility given the interdependent variables, technology, high fixed costs and the necessary long-term planning. It is also important to plan for uncertainty and prepare for change (e.g., through organization, strategy, and business planning, contingency and resilience planning).

**France’s Airport Landscape**

Mark Barges of Linklaters shared his legal insights from working in the airports sector in France. The French market used to be effectively state controlled. There were 3 primary categories of airports: Aéroports de Paris, Regional Airports (Nice, Lyon, Toulouse, Bordeaux, Montpellier), and the Decentralized Airports (about 150 airports representing less than 10% of the total traffic).

The EU authorities decided that a degree of competition and public tendering could help the French market. The market eventually evolved, effectively privatizing the industry. For the main airports, this meant transferring assets to a private entity through a long-term concession.

For the second category of regional airports, the transition involved short-term concession to a LLC, which enabled private capital to be brought in (the state retained a 60% share in each of those companies). The decentralized airports are still operated and controlled by local authorities.
This transition also brought about a change in the principles of economic regulation, notably a transition toward an “adjusted single-till” in which non-aeronautical real estate is not subjected to economic regulation.

**Top Considerations for Investors**

Ian Twinn of the International Finance Corporation (IFC) outlined nine important factors investors consider in making decisions. First, there needs to be an attractive market and realistic projections. This includes realistic traffic and tariff assumptions, which is correlated with economic growth. Unexploited revenue streams are also of interest (for example, the non-aeronautical side, location and catchment area outside the airport such as real estate).

The second is the PPP framework. Is the regime clear and fair? There needs to be a transparent award process as well as an independent regulator, with a reasonable time horizon. Performance targets need to be clear and achievable, and need to outline the consequences of non-performance.

Third, investors look for government and public buy-in. This will also impact mitigation of unintended consequences (such as resettlement, adverse environmental impacts, etc.) There have been varying levels of commitment in different countries, and where there has not been enough support there have been problems.

**Sponsors that have the appropriate technical know-how, a strong record, and local knowledge will be regarded favorably.**

Another critical factor for investors is the sponsor. Sponsors that have the appropriate technical know-how, a strong record, and local knowledge will be regarded favorably. In particular, management and financial capacity, and their ability to manage relations with the government and community and implement large construction projects on time and budget are vital.

The fifth factor concerns the technical design, which needs to ensure appropriate space allocation to prevent the airport from being overbuilt. Is the design up to date? How much flexibility is built in to accommodate for advanced in technology? Has benchmarking been performed?

The contract should also define the scope and quality of the works, implementation timeline, mechanisms to deal with cost overruns, changes in scope, delays, and defects and liabilities. The contractor should have a solid track record and adequate financial strength to carry out the work. Compliance with E&S performance standards should be addressed as well. This involves managing issues such as land reformation, solid waste, etc.

There should also be an appropriate security package including a mortgage on the concessionaire’s assets, pledge of shareholders’ shares, assignment of termination compensation under the concession, and an assignment of insurance proceeds.

Finally, the lenders direct agreement needs to be sufficiently defined. Lenders typically cannot take security over the fixed assets of the project (as these revert back to the government in a termination). They are typically not a party to the concession agreement; they therefore usually enter a direct agreement with the grantor and concessionaire to directly define and protect rights.

**The reality is the entire value chain is underpinned by traffic, which is influenced by many factors that are beyond anyone’s control.**

Mntonintshi highlighted that the reality is the entire value chain is underpinned by traffic, which is influenced by many factors that are beyond anyone’s control (e.g., political economy, oil prices, etc.) This also underscores the importance of having a flexible model to manage unforeseen circumstances. As a regulator, you can only oversee a part of the value
chain (airports) while the airline part is left to market competition.

Rigas Doganis argued that the industry need to change its way of thinking and move away from the obsession with traffic forecasts. Rather, we need to focus on what the airline business will do and how it is changing. For example, although Athens experienced 4-5% growth, the market did not grow because the environment changed and easyjet and others had started flying directly to the islands to capture the tourism market.

KEYNOTE ADDRESS

Muneer Ferozie, Regional Manager MENA PPPs and Privatization Financial Advisory, IFC

Muneer Ferozie’s keynote address focused on the challenges and opportunities of private participation in infrastructure in emerging markets. Infrastructure is critical for economic development. It facilitates urbanization, industrial growth, better trade and access to neighboring countries and regions. It also drives up GDP per capita, creates employment, and improves financial returns.

Over US$78 trillion is expected to be invested globally over the next 10 years, of which US$1 trillion a year is required in emerging markets. Emerging markets are expected to go from 30 to 40% of overall global market cap and generate over 50% of global economic growth. In fact, the share of global infrastructure spending in emerging markets has risen from 10% (in 2006) to nearly 50% today. By 2025, 21 of the 25 largest global cities will be in developing markets.

There is therefore still a lot of potential for growth in developing countries. In emerging markets, 45% of the population live in cities compared to 75% in developed markets. One percent of GDP invested in transport and communications is said to increase GDP/capita growth by 0.6%. One US dollar spent on capital projects in emerging markets increases GDP by between US$0.05-US$0.025, giving an economic return of between 5 to 25%.

Total private participation in infrastructure (PPI) in 2013 is estimated to be US$150 billion, a 24% decline from 2012 due to reduced spending in Brazil and India. The average project size was US$276 million, similar to previous years. The top 6 countries by rank are: Brazil, Turkey, India, Mexico, Russia, and China, accounting for 59% of commitments in developing markets. Transport makes up 22% of global PPI, 88% of which are new investments.

Despite the untapped potential in emerging markets, there are challenges that need to be overcome. Government support for infrastructure projects is
critical. But a lack of long-term political commitment, weak government capacity, a lack of infrastructure, and different levels of government (with diverging interests), regulatory instability and excessive biddings costs can hamper investment.

Another potential challenge is the lack of investor credibility. Investors may lack expertise in the infrastructure sector. There are also issues of scale for large investors (e.g., pension funds) and regulatory barriers. Many investors may also have a short-term vision.

The investment conditions can also be less than ideal. For example, there may be a negative perception of the value of infrastructure investments, a lack of transparency in the sector, and a shortage of data on infrastructure projects. Countries may also suffer from sovereign risk/poor country ratings which influence investor perceptions.

Other issues that can also impact investment in emerging markets include overall regulatory uncertainty, war/conflict, governance issues, and expropriation.

Advisors (including institutions such as the IFC) can play a meaningful role in increasing investment flows by mobilizing private financing as well as appropriately allocating risk to maximize the number of bankable deals.

Improving the capacity of the government counterpart (PPP Unit, through capacity building efforts) can also facilitate investment efforts, as can increasing the quality of deals to ensure attractive investments. The role of the advisor is critical to ensure projects are executed properly from due diligence to closing.

There also needs to be better coordination between institutional investors (who focus on cash flow generation stages) and the commercial banking sector (who are better prepared to take on the design/construction risk). International Financial Institutions (IFIs) and Export Credit Agencies have expanded their role in this space, and are currently the primary non-commercial lenders in emerging markets (US$27 billion in 2013).

Another positive trend is that large funds (e.g., pension funds) are moving toward a direct investment model with expanded terms and a focus beyond traditional developed markets. Investors are likely to look to emerging markets where expected returns and growth are higher than in developed markets.

Brazil has dominated the headlines in Latin America in recent years and other regional airport deals are being planned in the region. The Middle East is also going to see intensive activity over the next few years, but there are few privatization deals (except in Saudi Arabia and Jordan). Africa continues to lag behind the other regions as it struggles to develop new and existing airport infrastructure through private financing. Although there is expected to be a significant amount of activity in Asia (especially China), foreign involvement remains limited.

The traditional investors were infrastructure funds and construction firms (on Greenfield and Brownfield expansion). The global financial crisis led to an adjustment in the mix of airport investors. The new players in this market are pension funds with increasing focus on emerging markets, sovereign wealth funds, private equity, and operator/financial institution consortiums.

Strategic investors will move away from North America and Western Europe towards emerging markets (which offers reduced competition, higher return potential, greater pipeline, positive diversification, and lower valuation multiples). Governments will continue to push privatization to raise financing and attract expertise.
In summary, demand for infrastructure investment combined with high liquidity levels will encourage further growth over the coming years. Saturation of deals and excessive competition in developed markets will drive investors to expand their geographical focus to emerging markets. The mix of investors and strategies continue to evolve, especially in relation to emerging markets. Airport investments continue to be attractive and on the rise, albeit with intra-regional variations. Airport valuation levels appear to be steady (and are unlikely to return to 2006-8 levels). Emerging market governments will encourage privatization to raise financing, attract expertise, encourage wider investment, and stimulate economic growth.

Saturation of deals and excessive competition in developed markets will drive investors to expand geographical focus to emerging markets.

SESSION THREE: PPP AIRPORT CANDIDATES PRESENT THEIR CASES
Six airports from the Philippines, Paraguay, Papua New Guinea, Chile, Italy, and Brazil presented their cases to potential investors. The audience voted on a set of questions after the presentations.

Moderator: Kostas Iatrou, Managing Director, Air Transport News
Catherine Gonzales, Undersecretary of the Department of Transportation & Communication, Republic of the Philippines
Joseph Tupiri, Managing Director, National Airports Company, Papua New Guinea
Mr. Leonardo Montiel Pizarro, Director of Finance, Directorate General of Civil Aviation, Chile
Alfonso Diez, Technical Advisor, Paraguay
Martha Seillier, Director, Regulation & Competition, Civil Aviation, Brazil
Nazareno Franco, Managing Director, Aeroporto G. Marconi di Bologna

The third session gave six airports an opportunity to present their investment case. Following the presentations, the audience weighed in on the most convincing case and areas of improvement.

The Philippines

The first presentation covered PPP projects in the Philippines to be tendered. There are currently six regional airports that are in the very early stages of bidding. These airports will be bundled into two packages with three airports each. Package A consists of Puerto Princesa, Iloilo, and Bacolod-Silay airports, with a total investment requirement of US$1.3 billion. Package B consists of Davao, Laguindingan, and New Bohol (Panglao) airports, with a requirement of US$1.4 billion.
The contractual arrangement for these projects would be operate, add, and transfer. The maximum period for the concession is 30 years. The concessionaire will operate and maintain both the landside and airside facilities and will receive all the landside and airside fees. Air Traffic Control (ATC) and Air Navigation Services (ANS), as well as customs, immigration and quarantine will not be covered under the arrangement. The concessionaire shall develop and expand the landside and airside facilities, including passenger terminal building and cargo terminal expansion, construction of parallel taxiway, apron area expansion, and runway development.

Puerto Princesa International Airport is estimated to cost US$129 million. Construction of the new airport has already begun through an Export-Import Bank of Korea (KEXIM) loan. The second phase will be under the PPP. The project will also help decongest Iloilo Airport, which is currently operating overcapacity. Indicative costs are US$675.6 million. This airport also has high tourism potential, achieving 12% compound annual growth over the last 10 years. The third airport in Package A is Bacolod-Silay International Airport, and total development costs is estimated to be US$450 million. International operations are expected to commence this year.

Package B consists of Davao International Airport, and indicative project costs are estimated to be US$901.6 million. It is the 3rd busiest airport in the country and currently operating beyond capacity. Laguindingan Airport recently opened in June 2013 and was already operating beyond capacity given the project took a long time to complete. The indicative project costs are US$325 million. The private partner will undertake operations and maintenance of the airport and develop and construct new passenger terminals. On the New Bohol (Panglao) Airport, the project involves the operations and maintenance of the new airport which replaces the existing Tagbilaran Airport. The first phase is being financed through a Japan International Cooperation Agency (JICA) loan with a target completion date of mid-2017 for the PPP to commence. Indicative project costs are US$101 million.

Submission of qualification documents are expected on 11 May 2015, with the signing of the concession agreement by December 2015. There are other major ongoing airport projects in the country include Ninoy Aquino International Airport, Clark International Airport, and the New Manila International Airport (currently under study by JICA). The country has already had one major PPP (the Mactan-Cebu Airport).

**Papua New Guinea**

In the last 10 years, Papua New Guinea (PNG) has seen sustained growth of 6-7%, primarily underpinned by natural resource development. This year, GDP is forecasted to expand by 15%. With this backdrop, the government faces the challenge of building the necessary infrastructure and diversifying the economy. There is also potential to develop the tourism industry.
Given the geographical challenges in the country (high mountains, smaller islands), the (21) airports are spread throughout the country. The country remains heavily dependent on the air infrastructure as the roads network is still underdeveloped.

The PPP opportunity is Jackson International Airport in Port Moresby, the hub for Air Niugini (the national carrier). Traffic forecasts done by Leigh Fisher (hired as technical advisor to PNG) indicate 4 million passengers per annum (mppa) will be reached at Port Moresby by 2030.

In light of the APEC Leader’s Summit in 2018, the government wanted new terminal facilities and an extended runway in a short timeframe (December 2017) without compromising the marketability and economics of the airport.

The parliament passed the Public Private Partnership Act in September 2014. The Asian Development Bank provided policy guidance and assistance in drafting the legislation. Implementation of the act is beginning with the development of a centralized PPP center, which is critical for successful implementation.

The government has already shortlisted four bidders with signing expected to take place in June 2015. The National Airport Company (NAC), the company owned by the government which currently owns and operates the airports, has several objectives for the PPP: to improve airport operations, improve non-aeronautical revenue, grow hub and transit traffic, leverage air service network of prospective concessionaire-operator, and subsidize PNG’s regional airport network. It will be the first PPP project in the country, and there are hopes that it will help position PNG as a strategic leader in the Pacific to influence movements of traffic and grow routes.

**Chile**

The first airport presented was Diego Aracena Airport located in Iquique city. The upgrade and extension of the airport will require an investment of US$49 million over a period of 15 years (2017-2032). The development will involve an extension of the terminal, expansion of parking, extension of the commercial aviation and cargo aprons, and two new boarding bridges.

The second project is Carriel Sur Aerodrome in Concepción, estimated to cost US$45 million for 15 years (2016-2031). The airport will include an extension of the passenger terminal, a (2,600m) runway, four boarding bridges, commercial and general aviation apron extensions, and VOR/DME and ILS CAT III. Call for bids is estimated for Q3 2015.

For a Design PPP in Chile, the ownership remains with the State of Chile, which also operates the airside. The concessionaire operates the landside. For B.O.T, the concessionaire build, operates, and transfers.

In the bidding documents, two important categories ordinarily are addressed: i) economic regulation (hybrid model, single-dual till and hybrid price cap for monopolistic services), and ii) aeronautical and non-aeronautical services (embark and disembarkation of passengers, commercial aviation services in apron, commercial services in terminal, public parking, and non-commercial services concession area).

Other PPP projects are expected soon, including El Tepual Airport, Balmaceda Aerodrome (2019-2033), Chacalluta Airport (2019-2033), and Carlos Ibáñez del Campo Airport (2021-2035).

**Paraguay**

Paraguay is still in the early stages of its transaction, with feasibility studies currently underway. Nevertheless, this was a great opportunity to get a first look at the features of the project.

Aeropuerto Internacional Silvio Pettirossi (AISP) serves Paraguay’s capital city. It currently handles around 915,000 passengers a year and 10,000 commercial aircraft movements, 32,000 general
aviation flights, and 10,000 tons of cargo per year. The airport has a mix of LCCs, regional carriers, and local carriers. Various forecasts show a probable compound annual growth rate of ~4% over the next 30 years.

The airport is dealing with a number of issues related to ageing infrastructure, airside (with ICAO compliance issues) and landside (which was conceived in the late 70s and built in the early 80s). The infrastructure remains outdated, inefficient, and inflexible. This together with a positive traffic forecast, increased EU-Paraguay direct links, a positive business atmosphere, and geographic location warrants a comprehensive modernization program.

Capital investment would contribute to airfield enhancements (namely addressing pavement issues, runway, taxiway shoulders, etc.). Investment on the landside will consist of a new terminal building to replace the existing one. The design will be modular and flexible to adapt to future scenarios. There will also be a significant commercial focus (e.g., the configuration would allow for a central commercial plaza to maximize revenues, a new parking lot, etc.).

The airport is currently operated by the civil aviation authority (DINAC), which also acts as regulator, supervisor, and operator, a situation which is less than ideal. These roles are to be separated in the near future. In the context of a new regulatory framework for PPPs (which was approved two years ago), the modernization program will be implemented so that the Ministry of Public Works is the contracting entity for the project while DINAC retains a supervisory role, and the Planning and Finance Ministries supervise the process.

Brazil

Civil aviation has been growing rapidly in Brazil, with an average passenger growth rate of 10% in the last 10 years. This is largely due to economic growth, better income distribution, greater competition among airlines and a reduction in airfares. There was a 52% reduction in domestic airfares from 2002-2014. Load factors also have improved, with the domestic market increasing from a 60% load factor in 2003 to 80% in 2014. However meeting this demand has presented a major challenge for the existing infrastructure. In fact, figures show that although there are more people traveling, there are fewer airports serving demand. In 1999, there were 161 regional airports in Brazil and only 75 regional airports in 2014. Major airports (serving state capitals) have remained steady (31 nationwide). More investment therefore needs to be attracted to the regional airports.

Prior to 2011, there were only public administration of airports in Brazil. But there were major events such as the World Cup and the Olympics to prepare for. PPP was one solution to meet this expected demand.

There have been six concessions to date: Natal, São Paulo Guarulhos, Campinas Viracopos, Brasilia, Rio...
de Janeiro, and Belo Horizonte. Apart from Natal (which has no public participation), Infraero holds a 49% share. The (combined) winning bids total US$15.83 billion. This goes into a national fund and is reinvested in airports around the country. The average premium was 300% and the concession length varies from 20 to 30 years. Total investment for those concessions are around US$9 billion.

Most of the top 20 airports in Brazil have already undergone a concession (with the exception of Congonhas). The specific case that was presented was Porto Alegre International Airport, Brazil’s 9th busiest airport and the busiest in the south region.

The airport has seen an average growth of 10% in the last 10 years. It is primarily a domestic airport (7,833,000 domestic and 614,000 international passengers in 2014). Growth is forecasted to be 4% CAGR for the next 30 years.

This suggests a new airport will be needed around the 2024-2030 timeframe. The discussion is around whether the concession should be only for the new airport or for both old and new. As Seillier explained, it may be more feasible to have the concessions of both together. For the concessionaire, it will allow more cash flow from the existing airport while constructing the new airport. Brazil is still awaiting a presidential announcement on future concessions.

**Italy**

Bologna’s central geographic location, tourist potential, and healthy business and economic environment have contributed to favorable traffic figures (65 million passengers last year, 73% of which was international). Bologna saw a 55.7% growth in passengers, compared to the 12.5% average for Italy from 2008 to 2014. The master plan forecasts 20 million passengers by 2023.

Bologna Airport is a Share Issue Privatization (SIP) project. The shareholders decided to transfer ownership of their shares through an IPO which is expected to be completed before the end of the year. To expand the existing terminal and landside facilities, around €240 million will be needed from 2015 to 2023. There is currently no need to expand the airside facilities as there is still room for capacity.
On the regulatory front, a new framework was passed in 2012. Italy used to have a hybrid till system or “adjusted single till”. This is now a pure dual till, with cost-plus recovery with an allowed return on capital employed (ROCE).

It is envisaged that the regulation consultation and closing will take place by the end of 2015 (for the period 2016-2019), with issues such as the CAPEX plan and SLA (Service Level Agreement) on quality and environment to be regulated. Currently, 86% of total equity is publically owned. The Municipal, Provincial and Regional governments decided to reduce public ownership from 86% to 47%. This will be the first IPO for a regional Italian airport since 2007.

The Verdict

The audience was given a chance to weigh in on the presented cases, with a caveat from Schlumberger that “it’s not important to win, it’s important to participate”.

- The most promising presentation in terms of financial returns was Brazil [31%] followed closely by Bologna [29.3%].
- More than half of participants [54.4%] perceived Italy (Bologna) to carry the lowest risk for the investor.
- The audience voted Brazil [31.6%] followed by Papua New Guinea [26.3%] as the top case which made the most sense to choose PPP rather than to stay public.
- The presentation that was voted the best in terms of presenting all the important facts was Italy (Bologna) [32.1%] followed closely by Brazil [23.2%] and Paraguay [23.2%].
- And finally, the audience voted Brazil as having the highest chance of resulting in a PPP [37.9%] followed by Italy (Bologna) [27.6%].

During the discussion, delegates commented that where Brazil led the way was confidence in traffic growth. On the other hand, there was some skepticism about some of the cases on the size of the investment required and the practical return. For these, the willingness of the public sector to risk-share parts of these transactions would help.

In other cases, it was difficult to see the big picture (e.g., level of capital expenditure required and revenue expected to generate). The packages (of multiple airports) were more difficult to follow (e.g., it was not clear which airports were more economical, and which need to be subsidized). Many of the presentations were more focused on the economics of the transaction, while the regulatory framework and regime also was not very clearly presented.

Preparation of the deal (from a due diligence and execution perspective) is extremely important in attracting investment, particularly for emerging markets (where there could be an instable regulatory framework and ongoing governance issues). Another important dimension in establishing credibility for investors and lenders is the track record of government (in honoring its past commitments) and political stability and continuity. Advisors can play a critical role here.

In summary, building a convincing case requires adequate preparation (covering technical, legal, regulatory, and financial aspects) combined with convincing communication and political backing. The lesson for the airports is “less is more” – information presented needs to be clear, precise, and to the point.

SESSION FOUR: WORLD BANK BOOK
PRESENTATION “READY FOR TAKE-OFF”
Moderator: Professor Rigas Doganis, Visiting Professor, Cranfield University
Dr. Charles Schlumberger, Lead Air Transport Specialist, World Bank
Angela Gittens, Director General, ACI World
Nora Weisskopf, Air Transport Specialist, World Bank
Tony Davis, Chief Operating Officer, Irelandia Aviation

The final session was a presentation of the recently released book Ready for Take-off: The Potential for Low-Cost Carriers in Developing Countries by Charles Schlumberger and Nora Weisskopf of the World Bank.
Bank. Rigas Doganis moderated the session, and brought a unique perspective, having worked in the developing world and more recently as non-executive director for EasyJet. Angela Giddens, who authored the foreword for the book, opened the session with a few remarks on how LCCs have revolutionized the industry, impacting passengers, legacy carriers, and airports. This is a timely publication that raises important issues on the challenges and the potential LCCs can bring to a market.

**Objective**

The idea for this book began following two requests: one from inside the World Bank from the African Vice President who wanted to know, what could we do to help Africa develop air services? Why are LCCs not taking off in Africa and what does it take? A second request came from Declan Ryan of Ryanair (represented on the panel by Tony Davis of Irelandia). He was interested in finding out more about the potential for LCCs in Africa after having launched successful LCCs in Asia and Latin America.

LCCs have revolutionized the way we travel, and have been a key catalyst for the development of the aviation industry in the last decade. They have brought affordable travel to large parts of the population worldwide. Extensive research has been undertaken to analyze the business model and impact on the aviation sector and beyond. However, much of the research has focused on developed countries.

Therefore, the purpose of this book is to identify the premises and prerequisites of the LCC model, and assess whether this business model could be successful in other less-developed countries, in particular the countries of Sub-Saharan Africa.

**The Business Model**

In essence, most researchers define LCCs as carriers that (through a variety of operational processes) have achieved a cost advantage over full-service carriers (FSCs). This is translated to the consumer by a lower fare offering. Although many carriers are defined as LCCs, the LCC model has developed into many different variations since the original

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"Southwest Airlines model," the first U.S. LCC, which began operations in the 1960s.

There are a number of key characteristics that can generally be found in LCCs (see graphic). Although these common operating practices can be identified across a range of low-cost airlines, there is no one particular LCC model or a single driving element responsible for its competitive advantage.

The LCC business model has evolved rapidly in recent years (see chart). Many LCCs, particularly those in Europe and the United States have, for example, been “hybridizing” their models as more mature LCC competition, higher fuel prices, and powerful network alliances turn their focus to higher yield opportunities.

Even airlines such as Southwest have shifted more toward traditional models that cater to business traffic by using primary airports and adjusting their schedules. Their network counterparts, under competitive pressures from the new entrants, have also become more cost sensitive. Furthermore fuel prices have had a considerable impact on this convergence, with LCCs losing their advantage of more fuel-efficient aircraft to the fleet renewal process currently under way at most traditional
Impact of LCCs

Studies have shown air transportation to have a considerable positive impact on employment, gross domestic product (GDP), trade, tourism, and productivity, among other factors. Although some anecdotal evidence from developing countries is available, research on LCC entrance is almost entirely focused on developed countries, particularly in Europe and the United States.

This emphasis in the literature on LCCs in developed markets is largely due to their more recent emergence in developing markets and the unavailability of data. Specific focus has been paid to the impact of LCCs on traffic stimulation through lower fares and their overall impact on competition and fare levels in the market, (e.g., “the Southwest Effect”).

In Mexico, the emergence of LCCs has considerably stimulated traffic growth, with LCCs capturing almost 60 percent of the domestic market in 2012. They not only increased traffic from existing air travelers, but also attracted new flyers into the market. This was facilitated by the LCCs’ considerably lower fares, as well as an expansion of the historically limited domestic network. VivaAerobus, a Mexican LCC, estimates that a quarter of its customers are actually first-time travelers. Bus travelers, who had been enduring long rides on the country’s dilapidated road infrastructure, proved to be a critical customer base for the airline.

However, the effects of low-cost airlines can go far beyond fare levels and passenger traffic (e.g., tourism). Take the example of South Africa: On the Johannesburg-East London Route (which takes more than 8 hours by car), traffic increased by 52% between 2004 and 2006 when LCC 1Time entered. This played a major role in revitalizing the region’s tourism industry; and estimates suggest a 52% increase in foreign tourists translated into 62,000 additional tourists per year and equivalent of US$10 million in tourism revenues.

Prerequisites

The cases of both Mexico and South Africa offer some preliminary notions about the impact that LCCs can have in developing countries. However, the success of LCCs in these markets was dependent on certain market conditions. This book, which involved extensive research and stakeholder interviews, identifies the following key factors: (a) economic growth and a sizable middle class to drive demand; (b) air transport liberalization and privatization of monopolistic state-owned carriers; (c) the availability of adequate, low-cost air transport infrastructure; (d) the availability of qualified human resources; (e) appropriate safety and security standards; (f) low-cost distribution channels; (g) the availability of cost-effective financing for aircraft; (h)
fuel availability and cost; and (i) good governance to provide a sound investment climate.

**Case Study: The East African Community**

Based on this framework, the case of the East African Community (EAC) was chosen for further study. Although a preliminary assessment, the analysis indicates that, given the limited traffic domestically and in the region, combined with numerous challenges—such as the lack of a significant middle class driving demand, stalled liberalization efforts, limited safety and security oversight, few navigational aids, and limited human and financial resources to create a low-cost airline—the emergence of profitable LCCs in the region may be premature. However, in light of traffic forecasts, projected economic development, and a growing tourism industry, considerable opportunities may arise in the near future.

In order for LCCs to capitalize on these opportunities, stakeholders in the aviation industry will have to proactively address some of the challenges highlighted above. Although an LCC model may not be suitable at this point in time, there are significant opportunities for lowering costs and fares, and consequently stimulating the development of a competitive air transport market. This will in turn create the proper environment for LCCs to emerge. In the case of the East African Community as well as other developing countries, Multilateral Development Banks (MDBs) can play an important role in creating the conditions to capitalize on opportunities including:

- The fostering of a competitive environment by removing any market distortions (for example, monopolistic state-owned carriers, restrictive air transport policies, and bad governance);
- Investments, where required, in air transport and air traffic control infrastructure, in particular communications, navigation, and surveillance (CNS) infrastructure;
- Improvements in safety and security oversight through capacity building efforts in civil aviation authorities and airport operators (for example, training programs); and
- Reduction in input costs (for example, fuel and airport charges and taxes).

**Political Will**

Following the presentation, Rigas Doganis commented that liberalization appears to be the most critical missing element. How can airlines overcome that? Schlumberger agreed that it remains a major challenge, as the Yamoussoukro Decision is only applied by a handful of government. As the case of Fastjet has shown, despite developments in EAC, restrictions on traffic rights continue to stall growth efforts.

Weisskopf added that this is no easy task, as the privatization of a state-owned airline and fare regulation are challenging dialogues to have. Political will and convincing governments how liberalization can benefit economies will be essential. This can happen through better information, good governance, and pressure from the private sector. Neutral parties (such as the World Bank) can help further this agenda.

**The Investor’s Take**

Tony Davis used the opportunity to thank the World Bank for the study and for accepting Declan Ryan’s challenge. He commented that the challenge for investment firms (such as Irelandia) is the question mark after the book’s title. The key question is: Is there actually a market?

Irelandia has helped set up 5 different airlines in 4 regions (Ryanair in Europe, Allegiant in the US, Tiger Air in Asia, and Viva Aerobus and Viva Colombia in South America). The critical factor in these cases was the ability to foresee the commercial conditions (macroeconomics, growing GDP, and substitutability opportunities). The analogy used by Davis was “if people can afford to buy a pair of jeans, they can afford to fly on a low-cost airline”.

The study undertaken by the World Bank has identified that these factors alone are insufficient. In fact, it is all the other factors that go with that. Africa presents a great opportunity given its size, population, etc. but there remain a lot of issues that need to be fixed and challenges remain. For Africa, it appears that the answer to the question is - not quite yet.
MANAGING AIRPORT INVESTMENT, FINANCIAL MANAGEMENT AND ECONOMIC SUSTAINABILITY IN AN EVER CHANGING ENVIRONMENT

CHAIRMAN WELCOME
Professor Paul Dempsey, Tomlinson Professor of Global Governance in Air & Space Law and Director, Institute of Air & Space Law, McGill University

The benefits of air transportation are immeasurable. Air transportation is responsible for far more economic activity than its facial value and return to investors. Commercial aviation integrates disparate cultures and societies, and creates a global economy. In his opening, Dempsey said it is an industry that remains sexy. We are on the verge of taking people to outer space and are likely to see nonstop suborbital transportation within a decade. You can already get to anywhere on the planet in less than 24 hours.

The world is changing in phenomenal ways thanks to air transportation. Airports are an essential part of the industry and over two days, the conference will cover many aspects including finance, regulation, economics and pricing, and infrastructure.

KEYNOTE ADDRESS
Pierre Guislain, Senior Director for the Transport and Information and Communications Technology, World Bank

This year marks the first formal joint collaboration between WBG and ACI. With the successful launch of the ACI-WBG Annual Aviation Symposium which focused on PPPs, it promises to be a long and fruitful partnership.

The World Bank has set itself two ambitious goals: to end extreme poverty by 2030, and to boost shared prosperity by improving the livelihoods of the poorest 40% of the population in developing countries.

What does the World Bank do in airports? Although it is a fairly small part of the business, it is particularly important for certain groups of countries. Guislain’s speech focused on where investment in air transport reform and infrastructure can have a catalytic development impact, and the measures that need to be taken to unleash these opportunities.

Although the global economy is still struggling to gain momentum, aviation continues to grow at a faster rate than world GDP. We expect growth in developing and emerging markets to outpace developed markets. But where can more be done?

Africa has seen significant growth over the past decade, with major hubs developing in East Africa (for example, Addis Ababa). Ethiopian Airlines has also developed a broad international network and can now operate flights to many cities around the world.

Despite these examples of progress, Africa also faces a number of challenges in developing its air transport network, notably safety, infrastructure, and high protectionism. There is therefore a need to create viable and attractive markets. Africa has the lowest percentage of global traffic volumes, but has the highest accident rate, averaging 9.8 accidents per million departures from 2010-2012. The World Bank is currently working in many African countries to improve safety and security levels.

Major opportunities exist to improve the quality of infrastructure in Africa. In West Africa, no clear hub airport has yet emerged and connectivity tends to be low. This provides an opportunity that can be tackled with the right policies and investments.

A high level of taxes, fees and charges in many African countries continue to contribute to high fares (in addition to already high operational costs). For example, charges and taxes on a sample of West
African routes represent, in some cases, 50% of the ticket prices, or close to twice the norm elsewhere.

Liberalization of the air transport market can bring a number of benefits including new routes and frequencies, shorter travel times, and lower fares. For example, in Morocco, the 2006 Open Skies agreement with the EU led to a 160% rise in traffic, with the number of routes operating between the EU and Morocco increasing from 83 in 2006 to 309 in 2013. Implementing the Yamoussoukro Decision fully and creating an African open sky could boost the market tremendously and create significant opportunities for new entry and investment.

Landlocked countries also remain an untapped market, representing only 1.5% of global air transportation services. They face unique challenges including higher transport costs (particularly fuel costs and lower reliability of supply).

Another opportunity area for development is in small island states. These countries face challenges due to vulnerabilities from their geographic remoteness, smallness of economies, and high exposure to natural disasters. Key drivers of the Pacific Islands are tourism, remittances, and seasonal labor.

The World Bank is currently investing in Tonga, Tuvalu, Samoa, and Kiribati, through investments under the Pacific Aviation Investment Program (PAIP) focusing on infrastructure and institutional measures and capacity building.

The opportunities to develop underserved markets highlighted here underscore the importance of regional integration and collaboration between countries. Demand-side measures are also important including policies to stimulate tourism and regional trade, for example. Development partners can support countries in such efforts.

An increasing share of investment requirements in air transport infrastructure will have to come from the private sector. PPP trends show that airport investments tend to be lumpy and fluctuate from year to year. The Latin America and Caribbean region has had the most private investments in the last decade, followed by East and Central Asia, South Asia, East Asia and Pacific, Middle East and North Africa, and Sub-Saharan Africa last.

Another important issue that needs attention is climate change. In December 2015, countries will gather in Paris to reach a global agreement to tackle the issue. The World Bank remains committed to addressing the challenge through its client engagements (e.g., green airport projects such as the Shangrao Sanquingshan Airport). Together with ACI, the World Bank is also promoting the concept of Airport Carbon Accreditation. Bolder action is needed at a global and national levels to reduce emissions and contribute to a zero net emission world by 2100.

Together with ACI, the World Bank is promoting the concept of Airport Carbon Accreditation. In summary, there are opportunities for more impactful investments particularly in low-income and middle-income countries. What we need is support through policies, private investment, continued liberalization, and improving safety standards. The World Bank remains committed to working on these items particularly in the most difficult of environments, with the view that if the bank is successful, many others will follow by supporting and doing business in these markets.
SESSION ONE: STATE OF THE INDUSTRY

Angela Gittens, Director General, ACI World
Olivier Jankovec, Director General, ACI Europe
Patti Chau, Regional Director, ACI Asia Pacific
Jeff Poole, Director General, Civil Air Navigation Services Organization (CANSO)
George Anjaparidze, Senior Economist, International Air Transport Association (IATA)
Narjess Abdennebi, Chief Economic Analysis & Policy, International Civil Aviation Organization (ICAO)

Airport by Numbers

The first panel session was opened by Angela Gittens who provided a global view of the state of airports and a preview of the 2014 ACI Economics Report, the most comprehensive gathering of data on airports. This year’s report covers 650 airports, representing 70% of worldwide passenger traffic.

Overall traffic remained resilient in the face of economic, geopolitical, and health risks that prevailed in 2014. The economic headline is that while the industry remains profitable, this is true only for the world’s major airports. The majority of airports are small, and that majority produces losses.

The growth story over the last few years has been about emerging markets and developing economies. However, this growth has been more muted than past years. Advanced economies are starting to show signs of improvement. Passenger growth ranged from 3.2% in North America to 10.3% in the Middle East. The overall passenger growth in 2014 was 4.9%. Air cargo is also finally seeing growth, up by 4.4% in 2014.

Industry income grew by 5.4% as a whole in 2013 over 2012. European airports hold the greatest portion of airport income, however recorded the weakest growth at only 2.3%. The highest revenue growth was seen in the Asia Pacific and Middle East regions.

On the topic of income generation, Gittens commented on the distribution of aeronautical charges (charges related to aircraft and passengers).
While most airports derive their aeronautical revenue from passengers, North America derives most of its aeronautical revenue from aircraft landing charges. This can be explained by the heated debate in the US over passenger charges.

Aeronautical revenues alone are not sufficient to cover the costs of running an airport. Airport managers have increased their focus on generating non-aeronautical revenue. The move to revenue diversification has been critical to the financial resilience of airports and is the primary source of infrastructure financing support. (See chart for breakdown of non-aeronautical income). There are significant regional differences. For example “retail is king” in the Middle East, while “car parking is king” in North America.

Generally, airport profit margins rise as traffic volumes increase up to the 15-25 million passenger range. The challenge remains that most airports are small, with high traffic volumes concentrated in only a handful of markets. While the airport industry as a whole is profitable (with airports posting net profit margins in the realm of 16% in 2013), 67% of airports globally operate at a net loss. 80% of airports with fewer than 1 million passengers lose money. That is to say, of the airports that reported a net loss in 2013, 93% have fewer than a million passengers. Industry profitability is primarily driven by the 20% of airports that carry the bulk of passenger and cargo.

Airports worldwide had an average return on invested capital of 6%, with the highest return for airports with a passenger volume of between 5 and 15 million. Airports with fewer passengers have a negative return on invested capital of -3%. According to Gittens, this is not very different to that of the airline sector.

Beyond these numbers, airports continue to be an important economic source for job creation, generating multiplier effects from connectivity (e.g., for tourism and trade).

**The European View**

2014 was a year of strong recovery in Europe in terms of traffic figures, with 5.4% in passenger growth recorded. There remains a gap between growth at EU airports and non-EU airports, however the gap is closing.

Despite the fact that there has been recovery in passenger numbers, direct connectivity is down by 20%. Hubs are exposed to more competition from the Gulf airports which offer “intercontinental hub
connectivity”. In fact, 44% of airports in Europe are loss making.

Many countries are continuing to recover from the sovereign debt crisis and there remains a lot of uncertainty. Geopolitical risks also remain (e.g., Russia, Ukraine). The drop in oil prices is helping to ease conditions, but it has not yet translated into more capacity.

The Emerging Regions

The Middle East recorded the strongest passenger growth at 9.4% and 11.8% for air freight, the highest amongst all the regions. Middle East airports continue to pursue high growth strategies with their airlines.

Asia-Pacific airports recorded passenger growth of almost 6% and 5.7% in air freight. The most noticeable development in Asia has been the growth of LCCs. LCCs in Asia currently make up 25% of the market share compared to only 5% in 2004. Southeast Asia had the highest share of LCC seats (almost 60% in 2014). However the region had a difficult year in the wake of three tragedies.

Another notable development is the ASEAN Open Skies policy which came into effect on January 1 2015, with implementation expected later this year. The policy is expected to open the market to greater competition, improve connectivity, stir traffic growth, and improve service quality.

There will still be some challenging issues to address including slots and capacity constraints. In addition, the Philippines and Indonesia have yet to ratify the Open Skies agreement.

Privatization is increasingly being used by governments in the region to develop better airport infrastructure and management (for example, with a new government in place, India is reviewing its policies to boost the aviation industry).

Air Traffic Management

Jeff Poole described CANSO’s aim to transform the global air traffic management performance through their strategic plan, Vision 2020, and evolving the airport-ANSP relationship. Recently CANSO has worked proactively with industry and ICAO to address the losses arising from MH370 and MH17.

On safety, CANSO’s top priority, progress has been made on runway safety to reduce ATM related runway incursions. CANSO is also collaborating with ACI, IATA, and ICAO on the cyber threat through an ICAO high level group. A cyber risk assessment guide was published last year. A best practice guide will soon be published for ANSPs.

“AIR TRAFFIC MANAGEMENT IS, RIGHTEOUSLY, THE INVISIBLE PART OF AVIATION, BUT THAT DOES NOT MEAN IT SHOULD BE FORGOTTEN.”

A common thread that runs through these various activities is effective partnership (also a key pillar of Vision 2020), which is needed to successfully deliver and improve performance. Poole spoke about four areas to improve ATM performance for the benefit of airports, airlines, and passengers: 1) ensuring investment in infrastructure for both airports and ATM; 2) airport collaborative decision making; 3) allowing ANSPs to operate as normal businesses (e.g., through separation of service provision from regulation); and 4) exploiting the benefits of technology.

According to Poole, all parts of the aviation value chain still need to do a better job in joint advocacy to governments (to include ATM). A major concern is the imbalance between ANSPs and airports/airlines, particularly in terms of infrastructure investment. “I am always struck by the huge investments made by my airports and airlines, compared to the struggle that many ANSPs face in simply justifying investments in ATM infrastructure”.

Airport and ATM infrastructure must go hand in hand. “Air traffic management is, rightly, the invisible part of aviation, but that does not mean it
should be forgotten.” ATM can work more closely together to achieve these objectives.

Three Myths

George Anjaparidze of IATA made a presentation on the future of aviation and debunked three common myths. The first myth, according to Anjaparidze is that aviation's future is in emerging markets. While we can expect to see strong growth in these markets (driven by population growth, demographics, increased living standards, etc.), this is not the whole picture.

As the projections show for 2034, significant growth is expected to come from the Americas. There are concerns about the ability to meet this demand, such as the ability to meet capacity in the US (e.g., the last major airport was built in Denver 20 years ago).

The second myth is that “hub busters” (787s and A350s) will make hub airports less relevant in the future. If you see which airlines are actually placing orders, generally about 86% of these aircraft have been ordered by hub carriers, 9% by leasing companies, and only 2-3% by point-to-point carriers. In fact, this suggests that hubs are going to play a more important role in the future.

The third myth is that airlines want the most stringent form of economic regulation over airports. Anjaparidze argued that regulation needs to be “fit for purpose”, and that is what airlines want. There are costs in regulation, in terms of administering it. Regulatory intervention under the wrong circumstances can be harmful. It is important to weigh the costs and benefits. The appropriate level of stringency should be based on the aggregate level of impact the airport can wield.

The Regulatory Perspective

Abdennebi of ICAO highlighted the trends in connectivity and the impact of infrastructure constraints. The most critical component is market access (liberalization). In terms of the pace of liberalization, it is interesting to note that the number of country pair routes (of international scheduled services) has evolved from 6% in 1995 to ~37.5% in 2014 (see chart).
Some major obstacles towards more air transport connectivity are: unfair competition (restrictions on air carrier ownership and control), a lack of adequate infrastructure capacity, protectionism, and restrictive national policy on market access.

How is ICAO helping to improve air transport connectivity? It will continue to facilitate air transport liberalization. ICAO is providing a specific facility, The International Commission for Air Navigation (ICAN), to enable states to meet on a one-to-one basis so airports and airlines can meet and discuss proposed Air Service Agreements (ASAs).

ICAO policies oppose excessive taxation to the detriment of connectivity. ICAO is also attempting to level the playing field by fostering competition for both airlines and airports. Through its policies, it seeks to ensure a fair distribution of the costs of financing the air transport system.

KEYNOTE SPEAKER
Michael McGhee, Partner, Global Infrastructure Partners

McGhee shared the Global Infrastructure Partners (GIP) approach to airport development, and the proposition of financing a potential runway at Gatwick. GIP acquired Gatwick Airport for £1.5 billion in 2009.

The big question is always, is CAPEX investment needed or is there another solution? Generally, there is a tendency to “invest first, ask questions later.” GIP tends to “ask questions first” and only if all possibilities have been exhausted and investment is needed, a CAPEX solution is developed.

First, the development needs to be optimally phased. There is a trade-off here between reducing the unit costs of investment and not wanting to overbuild ahead of growth in demand. It is also important to “future proof” (e.g., for a runway, this means looking ahead to 2050). What are the future demands of the industry and how will it evolve? How will processes evolve?

Investment requires a thorough risk analysis and needs to make financial sense. There needs to be permission to grow with a package to mitigate problems for the local communities affected. Gatwick has been fortunate given its location (not central London and mainly flat farmland) which means there is minimal disruption during building. In addition, land has been safeguarded.

Gatwick also has the challenge of noise impact, with the number of people affected projected to increase significantly. This is a problem that affects the political deliverability of the project and one that any airport sponsor needs to address. The social and environmental package addresses property support, noise competition, and other issues (water course diversion, ecology, etc.).

Projections indicate that passenger growth will grow at 2.6% over the next 35 years, above the projected growth for London (2.3%). A midfield terminal is able to provide significant operational efficiency. Given that two-thirds of the London market is short haul, increasingly provided by low cost airlines, there is a need for fast turnaround times and operational efficiency.

There are three components to the £7.7 billion project: the airfield infrastructure (runway, terminal, land) at £6.2 billion; surface access infrastructure (road, rail, etc.) at £1.1 billion, and the social and...
environmental package which is estimated at £0.4 billion.

GIP also has a commitment to deliver competitive airport charges. Gatwick’s expected aeronautical fees will increase, but the fees are expected to be lower than the average of the primary airports in Europe. Key to this is risk – GIP will manage the airport development between the mentioned parameters (traffic, aeronautical revenues, and operational efficiencies).

The decision on the runway awaits. As McGhee described, GIP is prepared to take the risk by delivering a competitive airport set of charges and tackling the environmental issues. In GIP’s view, their scheme is the most affordable, sustainable, deliverable and best looking one!

SESSION TWO: FUTURE STRUCTURE OF THE AIRLINE INDUSTRY
Moderator: Andrew Charlton, Founder & Chief Executive Officer, Aviation Advocacy
Jonas Degerth, Marketing Director, Boeing Commercial Airlines
Robert Lange, Senior Vice President, Head of Market & Product Strategy, AIRBUS
Gordon Dewar, Chief Executive Officer, Edinburgh Airport
John Strickland, Director, JLS Consulting
Peter Morris, Chief Economist, Ascend

This second panel discussed what the industry might look like in the future. To make sense of what is to come, it is important to understand the factors shaping the environment. Moderator Andrew Charlton categorized these into four: Economics (market demand, new market, ability to pay); Technology (change, emissions, noise); Infrastructure (airports, ATM); and Regulation (liberalization, deregulation, environment).

Market Forecasts
Jonas Degerth from Boeing observed that airline productivity measures at or near peaks: 2014 saw 6%

Demand is only going to keep growing (see chart). Emerging markets such as China show only ~0.1-0.2 trips per person per year (y axis). As their income and quality of life improves (x axis), travel will increase as well. Both China and India have large markets, with a lot of domestic traffic, and this will drive future demand.

Boeing’s long term forecast predicts that airline traffic (RPK) will grow by 5%. This translates to demand for 36,800 new airplanes over the next 20 years, primarily for the Asia Pacific region (13,460) and in single-aisle configurations (25,680).

Democratizing Travel
Gordon Dewar said the aviation industry is now in the mass transit business, comparing it to the same stage the car industry was at in 1970. It is increasingly driven by economic growth, globalization, lower cost of travel, and new availability of routes.
Robert Lange of Airbus said the focus in aviation has changed from speed to affordability. Travel is ever more democratized. However despite the new route openings and networks, roughly 80% of the services in 20 years’ time will be in markets already served today.

In this context, Peter Morris of Ascend commented that aviation assets continue to be underutilized around the world and more can be done to attract airports, rather than relying on hubs.

Constraints

This concentration also raises concerns about capacity constraints. Of the 42 “megacities” (which account for more than 90% of passenger traffic today), 35 are already facing scheduling constraints today and could pose a potential barrier to growth. In 2033, this number will go from 42 to 91, and will account for more than 95% of long-haul traffic in the world.

The primary challenges will be dealing with airspace constraints and airport congestion, which results in extra fuel consumption and more CO2. The key steps forward will be driving for aircraft efficiency (aircraft improvement, more flexible use of cabin volume, ATM); operational efficiency (bigger aircraft, surface operations, e-taxi); manufacturing efficiency (manufacturing, product, end of life); and greater use of technology and data (connected passengers, aircraft, and airports).

Regulation

For an industry that is undergoing a lot of change (consolidation, new business models, and new aircraft types), what role does regulation play in supporting opportunities? As many panelists have already commented, liberalization of air services helps to foster growth of new air services. This has come under the spotlight with the Middle East and the Gulf carriers. The industry is also seeing the rise of cross-border business models (e.g., Air Asia, Norwegian).

Other factors include safety and security and the balance between better safety and increased risk. There is a need to improve tracking and intelligence sharing, but to do so in a way that is not burdensome and harmful (e.g., some measures such as no fly zones could impact networks and operating costs).

Other areas are the environment, slots, and consumer/commercial regulation. As Strickland pointed out, the industry has a very fragmented and inconsistent regulatory approach and we need to strive towards greater consistency.

Peter Morris commented that these dimensions discussed, one way or another, are pointing towards a greater focus on the customer, and a more demand-oriented operating environment.

SESSION THREE: REGULATORY FRAMEWORKS - BEST PRACTICE AND NEW THINKING

Moderator: Peter MacKenzie-Williams, Director - EMEA Aviation Practice, Leigh Fisher
Stephen Gifford, Head of Economic Regulation, CAA International
Hemant Mistry, Director, Airports & Fuel, International Air Transport Association (IATA)
Benito de Leon, Deputy Associate Administrator for Airports, US Federal Aviation Administration (FAA)
Keld Ludvigsen, Deputy Director General, Danish Transport Authority
Nick Dunn, Chief Financial Officer, Gatwick Airport

The third session focused on the topic of economic regulation, best practice and new thinking. The panel tackled the subject from different regional and industry perspectives.

Evolving Process in the UK

The UK regulatory approach has evolved considerably. It was only after the 1986 Act that economic regulation became more prominent and
came under the purview of the CAA (e.g., price caps were set at Heathrow, Gatwick, Stansted, and Manchester). Traditionally, it was only limited to safety regulation.

The CAA has moved away from a systems approach to regulation to a more tailored approach, to a standalone regime for each airport (which has remained). The UK has retained the single till system. Following the passing of the Civil Aviation Act (2012), the CAA was given a new primary duty to focus on passengers, and a greater prominence for competition.

For an airport to be regulated economically, it must pass a three-stage test: 1) it must have substantial market power; 2) competition law alone does not provide sufficient protection; and 3) the benefits of regulation must outweigh the adverse effects. Although the CAA now regulates only two airports (Heathrow and Gatwick), they account for 50% of passengers.

To allocate risks to those best placed to manage them, costs have been categorized into 3 categories: Category A (costs for engaging the commission), Category B (the planning process), and Category C (construction) which is expected to be the most substantial.

It was decided that Category A costs should not be passed onto users. A threshold is set for Category B (some spending allowed). Category C costs are based on a principles based approach where commercial negotiations should be encouraged. Second, risk should be allocated to those best able to manage it. Third, capacity can be paid for both before the airport opens (through prefunding) and after it opens. Gifford stressed that regulation should not crowd out commercial solutions that might be beneficial to users.

Nick Dunn provided an overview of developments at Gatwick and the potential new runway. In a competitive airport system with separate ownership, Dunn argued that regulation is no longer desirable. Regulated Asset Base (RAB) regulation undermines the airport-airline relationship. With a focus on inputs rather than outputs, it does not incentivize innovation.

The alternative is a fixed legally binding agreement and a commitment to a specified level of service. It also limits airport charges through a net limit. This alternative also offers scope for bilateral contracts (e.g., no crowding out of commercial relationships). Overall, this ensures price and service certainty.

The Airport Commission is currently looking at options for a new runway, and the CAA is awaiting the Commission’s decision.

**The Airline View**

The focus of Hemant Mistry’s presentation was on the need for partnerships and “effective regulation” from the perspective of the users (airlines). There is a healthy tension between the airlines and the airports however both sides also have a mutual interest in making sure effective and efficient capacity is available at airports. There needs to be a more integrated approach to airline-airport management.

Given the scarce resources, investments need to be focused on the right areas. For example, CAPEX should seek to address determined bottlenecks,
particular in infrastructure planning. If capacity is not in the right places (i.e., where there is passenger demand), it will likely result in slot constraints. We need to avoid CAPEX that is not being driven by user demand. Airlines and airports should work together to determine the scope, size, and affordability of CAPEX.

According to Mistry, asymmetrical efficiencies demonstrate the need for effective regulation (see chart). The lack of a competitive market also warrants effective regulation. For example, to protect the interests of users (both airlines and passengers) from excessive charges, to ensure the right incentives are in place, and quality services are provided. Getting there requires a constructive and consultative engagement process between airports and the airline community.

The US Approach

Around 3,331 of the 19,360 total airports in the US are included in the National Plan and therefore eligible for national funding. The Federal Aviation Administration (FAA) has identified four strategic initiatives: 1) Make the aviation system safer and smarter; 2) Deliver benefits through technology and infrastructure (e.g., NextGen); 3) Enhance global leadership (by improving safety, efficiency, environmental sustainability); and 4) Empower and innovate the FAA (talent management).

The US approach to rates and charges are based on a few key principles. Rates and charges need to be fair and reasonable, non-discriminatory, provide for public access, support economic self-sufficiency, and retain airport revenue on the airport.

The FAA has a number of initiatives on airport safety, efficiency, and environmental sustainability. FAA also supports a number of research projects and pilot projects, partners with industry, and publishes technical guidance. Regulations are only put in place when necessary – and often to codify what is already widespread practice.

However, there are some downsides to the US approach. Change is very difficult and substantial effort is required to change policy. Privatization of ownership has not progressed in the US. Congestion continues to be a challenge at the busiest airports. Preserving competitive access in spite of airline industry consolidation remains another challenge. In addition, there are continued efforts to improve noise and air quality impact and to implement safety management systems (SMS).

Failure to enact long term, comprehensive aviation legislation has had a negative impact. Without a long term funding bill, it is difficult to plan for financing. Airports are deferring projects and focusing instead on preserving and rehabilitating existing infrastructure and revenue-generating facilities.

In spite of these challenges, there have been a number of accomplishments recently. Since 2000, 16 new runways have been built ($513 million in funding); improvements to Runway Safety Areas (RSA) and terminal projects ($2.4 billion in funding) have also been made.

The Danish System

Ludvigsen focused his presentation on the regulatory system in Denmark and in particular Copenhagen Airport (CPH), the largest airport in the country. The airport has 145 direct international routes and 25.6 million passengers in 2014. It was corporatized and became a listed company in 1994. Today, private international investors own 61% of shares while the Danish government owns 39% of shares.

The parliament decided to regulate CPH in two ways through the Danish Air Act, through restricting capacity and charges. These are closely related and complement one another.

The privatization of CPH brought a number of advantages, for example revenue for the state and a dynamic business approach. The cons included the risk of a hostile takeover and risk of underinvestment. This required balanced regulation to assure the attractiveness of the airport to airlines and the long-term investor.
What makes an airport investment attractive? The last session of the day explored the critical risk factors in considering an investment. The panel was well represented by a lender (risk sharer), investor (risk manager), and operator (risk taker).

**Operator**

Dr. Yiannis Paraschis presented the case of Athens International Airport, a pioneering PPP Greenfield project. The government owns 55% (Hellenic Republic Asset Development Fund has a 30% stake and the Greek State has a 25% stake); the private sector owns 45%. It is a 30-year BOT concession contract.

The PPP involved a lengthy process beginning as early 1975 with the decision to build a new airport, followed by the tendering process in 1991, and establishment of Athens International Airport in 1995.

Athens is a case of disruption, according to Paraschis. Actual traffic suffered from many ups and downs including 9/11, the 2004 Olympic Games, and the Greek debt crisis. From an investor’s perspective, traffic did not necessarily perform as expected (see chart).

From a risks perspective, there were many to consider: construction risk, opening and operational risks, risks with Olympic Airways, as well as currency risk. Fortunately, according to Paraschis, financial results were better than expected with higher commercial revenues, efficient cost management, pricing policy, and dividends.

**Lender**

Dan Robertson offered the lender’s perspective by comparing the risk profile of airports versus other infrastructure asset classes (e.g., toll roads, utility networks). Investors are often looking at a variety of infrastructure investments, so airports are in competition with other sectors for both debt and equity capital. In terms of credit risk, airports compare favorably with other sectors (see chart).

Airports have positive and negative aspects for investors. Positive factors include potential for revenue growth, diversification from domestic economy, flexibility to respond to downturns, including adjustment of CAPEX and operational expenditure (OPEX), and ongoing debt funding requirement.
On the other hand, there are negative aspects as well such as airline fragility and risk of strategy change (e.g., route changes). These require complex case-specific analysis (which may dissuade some investors), exposure to competition, and a substantial amount of discretionary leisure and retail spending risk (e.g., role of leisure traffic and the importance of non-aeronautical revenues, as compared to toll roads/utilities).

Unlike other sectors, there is a wide range of risk profiles in airports, from lower volatility investments (major hubs and historic traffic performance), to more volatile secondary airports (more exposure to LCCs), to emerging markets (governance risks, FX risks, and reliance on government mandated programs). Although some degree of sophistication is required to invest in the sector, it can offer greater diversification of options compared to other sectors.

Investor

Amit Rikhy explained why the airport sector remains attractive for investors. The sector has high barriers to entry, diversified revenue streams (aeronautical and non-aeronautical revenues), and can provide resilient cash flows over the long term. Associated risks need to be considered carefully. “Airports are not emotional investments, but they are emotional assets” (connected with the community).

Success factors include air service development, commercial development, real estate management, commercially focused operations, life cycle CAPEX management, and stakeholder engagement (and the diversity of stakeholders to whom an airport has to cater).

Risk mitigation measures can help create greater value for the investment. For example, forming risk committees with both operational and investment perspectives. Investors also undertake scenario planning and put in place strategies to respond and recover rapidly. Stakeholder value can be enhanced through risk management measures covering financial, strategic, and operational aspects.

SESSION FIVE: AIRPORT PERFORMANCE MANAGEMENT

Moderator: Chris Poinsalte, Chief Financial and Executive Officer and Immediate Past Chair, ACI Economics Committee, CFO and CEO, VP Finance and ITS, Dallas – Fort Worth Airport
Miriam Ryan, Head of Strategy, DAA and Chair of ACI Europe Economics Committee
Donagh Cagney, Economics Manager, ACI Europe
Qi Wu, Managing Partner Greater China, Roland Berger Strategy Consultants
Declan Collier, Chief Executive Officer, London City Airport
Alexander Springer, Chief Executive Officer, prevero

Effective Solutions

Alexander Springer spoke about how technology can enable Performance Management (PM) from the perspective of a solutions provider. A recent survey indicated that only 10% of financial professionals know what CPM stands for (Corporate Performance Management), or simply Performance Management.
Performance Management (PM), an essential part of optimal and informed decision making.

PM addresses questions such as how will the air traffic market demand develop in the future? Are we in a position to invest our own funds? Do we have the manpower and physical manpower to accommodate demand? It brings together historical data, monitoring, current data, and future planning in one integrated platform.

The key point Springer made is that it is important that all stakeholders can be combined in the decision making process, such as the owners (management, investors), customers and partners (airlines, concessionaires), users (passengers), and other stakeholders (tourism, controlling authorities).

In summary, Springer recommended focusing on a few key areas in choosing a PM solution: it has to be consistent (from strategic concept to action), and it has to be complete (integrating all fundamental business segments). It also needs to be multi-perspective and focused (choosing a partner that knows the industry).

China

Qi Wu of Roland Berger addressed trends in the Chinese airports. The Chinese government has an ambitious target to grow the number of airports from 200 to 230 by 2015. However, figures show 74% of Chinese airports currently incur losses.

The break-even point (in terms of traffic) is much higher in China, with the analysis showing that the point is in the range of at least 3.2 million passengers. The top three hubs (Beijing, Shanghai, and Guangzhou) clearly outperform the other airports. These airports have a higher proportion of international and business passengers, and also charge higher landing rates.

Looking to the future, the Chinese government will build more airports in the Central/Western regions with the aim of building more hubs. Many of the cities are also thinking about combining airports with city development, to better leverage infrastructure (e.g., airport city/zone).

Europe

Donagh Cagney shared some results from ACI’s study Performance Management at European Airports and what it means in practice. The adoption of Performance Management (PM) is part of a larger trend of airports becoming more corporatized and operating in a more competitive environment.

The first impression was that there is plentiful diversity in the way airports are tackling this discipline. For example, where the PM function is located in the organizational structure and the frameworks they use vary considerably.

Most airports are using PM for a broad range of areas including operations, finance, safety, and commercial, and to focus on the issue of service quality. The study revealed that the practice of data collection and benchmarking is also well established at airports, both internally (against past performance) and externally (against competitors).

The variance is expected due to the variability in airports themselves, notably different geographies, customer demands, working cultures, and different strengths and weaknesses.

One area that can be developed further is frameworks – how do you get the findings from the PM back into the system? There is also some potential for maturity, but overall PM appears to be well embedded in the operations of European airports.

Ireland

Miriam Ryan shared Dublin Airport Authority’s (DAA) approach to PM. As the other panelists pointed out, it begins with a purpose and vision, and then proceeds to guiding principles (goals, strategy, and values). Strategy happens through milestone plans (outputs and actions), scorecards (current year actions), and personal objectives (personal performance, deliverables).

Ryan stressed that KPIs need to link to the strategic goals, “if we are measuring the wrong things, we are moving in the wrong direction”. For example, one of DAA’s key objectives was to develop Dublin as a hub. This influenced the way progress was tracked against KPIs to meet that objective (e.g., transfer passenger
processing times and level of satisfaction, and the market awareness of Dublin as an emerging hub).

Ryan also emphasized that it should be about more than just financials. KPIs need to be balanced with the customer (passenger numbers, rankings), optimum return (EBITDA targets, etc.), strategic focus, and people and processes (staff surveys, E&S).

Ryan also stressed the importance of focusing on outputs is also essential (which are also easier to measure). It is also about what you do with the information once you have it – i.e., active management and frequent progress checks are essential. When these are met, organizations need to communicate and celebrate success (e.g., through town halls, social media). As Ryan summed it up, at the end of the day, PM is the tool to getting things done at DAA.

**London City**

Collier shared some examples of initiatives being done at London City Airport (LCY). The airport operates in the world’s busiest airport system. 144 million passengers came into the London area last year. Four million passengers came through LCY. Around 61% of passengers going through the airport are business passengers.

As the only airport situated in the city, LCY’s core proposition is centered on speed, location, and experience. There are plans to grow the airport (e.g., new parallel taxiway, more stands, and expansion of terminal). The airport has tried to combine the use of technology and innovation with PM to carry out these expansion plans while maintaining their proposition.

LCY’s solution, “The Smart Airport Experience” uses 200 cameras around the airport to cover every aspect of the airport in real time (while preserving the privacy of the passenger). For example, passenger time, flows and aircraft movements are monitored. That data is then transformed through a system of KPIs and algorithms to produce a dashboard. For example, Collier shared that currently it was taking passengers, on average, 9 minutes and 30 seconds to get from the door of the airport to their plane, and 12 minutes and 31 seconds from their plane to their train.

This tactical data is then moved to the strategic sphere, to model changes in processes and infrastructure for both people and aircraft (e.g., changes in security measures). This system has helped LCY maintain its value proposition and implement a number of exciting initiatives, such as the 60-second check-in process, the Bloomberg Hub, and immigration e-gates.

**SESSION SIX: AVIATION - THE ECONOMIC MULTIPLIER**

**Moderator: Dr. Charles Schlumberger, Lead Air Transport Specialist, World Bank**

**Olivier Jankovec, Director General, ACI Europe**

**Jonathan Gillham, Senior Consultant PwC and Daniel Hanson, Director, Economics & Policy Team, PwC**

**Liying Gu, Managing Director, Finance and Research, ACI North America**

**Pierre Guislain, Senior Director for the Transport and Information & Communications Technology Global Practice, World Bank**

Schlumberger moderated the economic panel and posed the question: What does the aviation industry mean in economic terms?

**Economic Impact Study**

ACI recently released the Economic Impact Study and Olivier Jankovec shared some of its key findings, and the need to align policymaking. Building connectivity is key to delivering a positive impact on the community.

Jankovec argued that there is often a wrong perception that the commercial mandate of airports is not good for society. However beyond the commercial benefits of airports, we also see that many airports in Europe are embracing corporate social responsibility (CSR) in operations.

Europe is currently reviewing its aviation policies and a new aviation package has been announced. It is
important for the industry to be able to influence that process. This is where advocacy will play an important role to change the perceptions of policymakers. Europe is becoming more dependent on aviation, and it is key to the EU’s growth and jobs agenda.

Last June, ACI released a comprehensive guide that measures airport connectivity. Following that report, ACI is now putting a price tag on that connectivity through this economic impact study, by linking air connectivity and the economy and quantifying that link. This includes direct impact (in the vicinity of the airport), the indirect impact (by the industries that supply and support the airport), the induced impact (by economic activities of employees and companies that are directly or indirectly linked to the activity of the airport), and the catalytic impact (the wider economic benefits that extend to trade, tourism, investment etc.). An increase of 10% of connectivity results in 0.5% more GDP, shared Jankovec.

According to the study, airports along with aviation partners are making a significant economic contribution in Europe (4.1% of total GDP and more than 12.3 million European jobs). There is variation between countries in Europe, ranging from 1.1% to 7.1% of GDP (e.g., higher for more isolated or tourism dependent countries).

Eurocontrol predicts by the year 2035, Europe will not be able to meet 12% of passenger demand due to a lack of airport capacity. This will result in unrealized jobs and GDP growth for the region. Jankovec said this is an important political message when we talk about supporting capacity expansion. We need governments to be more supportive of the sector.

**The Aviation Multiplier**

Gilham and Hanson of PwC talked about the aviation multiplier and why it is important. Aviation is a large and growing sector. It drives and is driven by economic growth. Providers of capital (both public
and private) want to maximize their return. Aviation is also a sector that can have transformational effects, which makes assessing it difficult.

Aviation multipliers can have different impacts (see chart), from the local level (e.g., airports) national, and international (e.g., cargo) levels. Airports with high multiplier effects have a large proportion of business travelers which generates a productivity effect, according to the PwC research. A 10% increase in passenger numbers can also result in a 4% increase in tourist arrivals in the UK and 1.7% increase in UK goods imports and 3.3% in exports.

**Elasticity and Impact of US Airports**

Liying Gu spoke about the US system and the economic impact of commercial airports. US airports generate significant economic benefits, including 6% of US jobs and 7% of US GDP. As Gu showed, the distribution of economic impact generally matches the distribution of the population (see chart).

Government policy heavily influences the aviation industry. Passenger numbers increased significantly following deregulation in the US in 1978. There is an ongoing debate in Washington over passenger charges. The airport industry is capital intensive and relies on investment to preserve assets and invest in new facilities. ACI is predicting a funding gap of at least $5 billion a year for the next 5 years. The policy debate is centered on how to finance the system e.g., through a proposed $4 Passenger Facility Charge (PFC) increase.

With regards to passenger charges, they typically present 30% of total aeronautical revenue. But in the US, airports generate the smallest share of aeronautical revenue from passenger charges compared to other regions ($4.50 PFC) as opposed to $30.15/PAX charge in Europe.

Gu also discussed the demand elasticity ratio, whereby quantity decreased when price increases. Business travelers are typically less sensitive to price changes. Short-haul routes typically have higher demand elasticity than long haul routes. Inbound travel originating from overseas is more price sensitive. Income elasticity is typically positive (as air travel is considered as discretionary spending).

**Development Impact**

Pierre Guislain of the World Bank commented on the impact of aviation for the developing world. Air travel is generally correlated with business activity and confidence, and highlights the importance of connectivity. In many cases, when you have isolated markets or fragile countries that come out of conflict, the ability to restore reasonable traffic and basic infrastructure (phone connectivity, hotels), can reestablish business links.

As others have already mentioned, there is also a strong correlation between air travel and income. The rise of the middle class in emerging markets is another strong development for aviation. Some of the growth in air traffic is driven by growth in propensity, but the reverse is true as well. An increase in GDP is made possible due to an increase in connectivity.

This is particularly the case for tourism. It is the 4th largest industry in the world with aviation. One-third of developing countries see tourism as their leading export earner and 82% of developing countries name tourism as a key foreign exchange earner.

How do you unlock a market? Often, what is needed is a broader focus, beyond single sector activity. If
you want to unleash the full potential of tourism, for example, you need to unleash connectivity and build affordable access, but you also need to work on the destination offering itself. This means working a number of different ministries and agencies with diverse interests that are not necessarily aligned.

Guislain shared the example of Samoa where in 2004, the national airline (Polynesian Airline) had a deficit which represented 70% of the government’s total budget deficit. IFC, the World Bank’s private sector arm, advised the government. The result was a joint venture, Virgin Samoa. As a result, there were more direct and higher frequency flights. It also resulted in a 45% reduction in air fares, with significant tourism growth (4% per annum to 15%). However, it often takes political energy to make the case to invest in high value activities – the induced effects can be extremely important.

Trade is the other obvious link. Air transport carries around 35% of world trade by value and only 0.5% by volume. There are plenty of examples (such as Kenyan flowers). In the case of Tanzania, the country benefited immensely from the development of the fishing industry through the export of processed fish from the Mwanza region.

However, this case also shows that dependency on air connectivity was also a significant risk factor as the industry suffered following a drop in flights to/from the region, which impacted their capacity to export. It also shows the importance of ensuring the sustainability of these interdependent activities.

 Creating Awareness

The Q&A discussion raised the issue of advocacy and communicating these messages on the value of aviation to governments and the public. The environmental debate in particular, has raised concerns. As Jankovec said, “In many countries, flying became like smoking.”

A lot of work has been done on reconciling aviation goals with environmental and social goals. Calderon from the European Investment Bank commented that impact studies do not fully communicate aviation’s value. What aviation adds is impossible to substitute, particularly for long haul routes. Hanson of PwC added that it is difficult to capture the endogenous nature of aviation, as it both drives and is driven by growth and capturing the causal effects is challenging. The difficulty is getting the message out beyond the transport community.

SESSION SEVEN: SUPERCHARGING NON-AERONAUTICAL REVENUE STREAMS

Moderator: Martin Moodie, Founder & Chairman, The Moodie Report
Jonathan Coen, Retail Director, Heathrow Airport
Eugene Barry, Executive Vice President, Commercial Group, Dubai Airports
Keith Spinks, Secretary General, European Travel Retail Confederation (ETRC)
Ibrahim Ibrahim, Managing Director, Portland Design Associates
Johan Schölvinck, Vice President, Commercial, INTERVISTAS consulting and Vice Chair, ACI Europe Commercial Forum
Paul Topping, Director, Flemingo International Ltd.

The final session focused on the topic of non-aeronautical revenues. How are airports changing the business model and reliance on traditional revenue generation? The shift towards commercial revenues is driven by a number of factors such as more privatization, downward pressure on aeronautical revenues, and the need to fund infrastructure growth.

The Heathrow Experience

Shifting reliance from aeronautical to non-aeronautical revenues is not a new concept for Heathrow. The regulatory model (single till) has
incentivized the airport to find new revenue streams. This also improved commercial and operational performance.

There are a number of security and safety requirements that can pose a challenge for airports. This means that airports have to come up with creative ways of stimulating commercial activity and revenues from customers. As Coen shared, for Heathrow, commercial activities are “on the way” rather than “in the way”. Airports have to make sure that commercial activities do not compromise the operations of the airport.

Beyond revenues, Heathrow has sought to build a customer experience through key initiatives: making dining an experience; personalizing services; rewarding customer loyalty; and providing enhanced support for retail partners. This is complemented by social media channels, reaching out to passengers outside the airport, as well as dwell time - “the currency of airports”.

**The Dubai Experience**

Eugene Barry shared Dubai’s model of growth through some practical examples. On average, Dubai welcomes 190,000 travelers a day, process 150,000 bags a day, and operate over 970 flights a day. At the heart of the commercial strategy is Dubai’s duty free, which processes 97,000 transactions daily.

For Dubai, a relatively small city, the impact of the aviation sector is large. In the period 2010-2014, passenger numbers grew by 54%. Aviation contributes 27% to Dubai’s GDP and 21% of the workforce rely on aviation. By 2035, it is estimated that aviation will contribute to 45% of GDP and one-third of national employment.

Dubai is expanding its capacity, as Dubai International is nearing completion of the $7.8 billion investment program, which will raise capacity to 90 million passengers a year. This growth has also been enabled by a policy of open skies.

The focus is increasingly on improving the passenger experience, emphasized Barry (e.g., minimizing waiting times, walking distances, efficient passenger processing, and digital tools).

Retail has been essential to generating the cash flow required to make investments in the sector. Dubai Duty Free had a sales turnover of $1.9 billion last year. Dubai has also adopted integrated space planning and tailored retail for a very diverse traveler group (e.g., luxury fashion to confectionary).

**Protecting Commercial Revenues**

Retailers such as L’Oreal are calling airports “the sixth continent”. Given the commercial potential of airports, what does the industry need to do to grow non-aeronautical revenues?

Airports are a unique retail channel, operating 24/7, with an international customer base. Every category of retail sales is growing (see chart). However, the industry is also facing increased regulatory restrictions which are affecting the ability to sell.

There are also aviation and airport security measures which impact retail time. Airline baggage policies (e.g., the one bag rule) are also impacting passenger behavior. According to Spinks, the biggest issue is the provision of consumer information, and demands to provide more information on labels (in the EU, in the language of the country in which it is sold). There is an ongoing discussion at the EU level on the rights of the passenger. Spinks reiterated the importance of working together as an industry to find innovative solutions to tackle these challenges.

**Transaction to Interaction to Intimacy**
Ibrahim Ibrahim talked about changing the airport retail landscape from transaction to interaction to intimacy. We need to be able to adapt to changing customer expectations and behaviors, we need to “future proof” our airports.

“Retail is all about people and places, not building space spaces,” said Ibrahim. Airport retail needs to move away from the physicality of space to the emotion of place. To do this, we need to better understand the customer set.

The key demand from customers today and in the future is control. “Generation C” is constantly connected, collaborative, co-creative. They want to be part of a conversation, build communities, and they have a conscience. This is a sea change in consumerism and retail.

Ibrahim stressed that the “cookie cutter” model of airports and commoditization is outdated. The new model is shifting from buying and selling (transaction) to interaction to intimacy with customers. “In this new world, participation is the new consumption.” Branding is now about rituals, rich meanings, lasting connections – true loyalty.

“Data is the new oil”. It is vital for retailers to understand every part of a customer journey (profile, personal history, and preferences). In the airport world, customers are “transumers” who behave in a different way. We need to understand the mindset of customers in transit.

### Retail Challenges

John Schölvinck of InterVISTAS described several issues facing the airport retail industry as it continues to transform. First, as airports continue to privatize there is more of a focus on non-aeronautical income. Second, travel retail consolidation means that retailers can either acquire or grow organically (size matters).

Brands are also not willing to foot the increasing bill of airport demands for high fees and are now looking for other channels. There is a worry that airport retail contacts are not sustainable, with short time spans and high concession fees. Collaboration between the “trinity” (airports-retailers-brands) must intensify, said Schölvinck. Airports and airlines are not working together enough (e.g., on sharing of data, in-flight retail).

Finally, Schölvinck stressed the point that governments, investors, and architects must remember that airport retail needs to be planned from the beginning (e.g., early on in terminal designs), and not treated as an afterbirth.

### The Travel Retailers

Paul Topping shared his insights on the changing business model of airport retail from the perspective of a travel retailer (Flemingo). Having strategic partnerships is critical in this business. For example, their partner in India is DFS, one of the leading duty free companies in the world.

Second, as a fast growing business, balancing risks is important. For example, being on airports and having operations beyond airports. In addition, strategic investors and growth by acquisition have been key parts of Flemingo’s growth.

What do the customers really want and what do people buy? Flemingo research indicates that only 74% of the travelers who had planned to purchase bought in duty free. 27% said it is too expensive; and 50% could not find the right brand.

How are travel retailers changing the business model? By increasing space, and creating a luxury retail environment. Retailers are also expanding their product portfolio and increasing investment.
In addition, retailers are making efforts to make promotions more interactive, maximize arrivals (shopping), track customers, and invest in knowledge/skills and data. Other trends include loyalty programs, e-commerce and mobile apps, social media, and home delivery.

What are the threats from the perspective of retailers? With increased retail space, are customers getting overwhelmed by choice? Other threats include regulation and legislation allowances, baggage restrictions, economy/forex fluctuation, and online retailers. This presents an opportunity for retailers to be more creative and collaborative.

A More Collaborative Future

The Q&A discussion raised concern over the lack of collaboration between airports and airlines. The example of Air New Zealand was given – the airline cut out on-board retail a few years ago. Could they have collaborated better with airports?

Beyond sharing of data and in-flight retail, other practical examples of potential areas for collaboration include speedy boarding procedures, and revenue sharing arrangements. We must remember that passengers do not have boundaries when they travel (between airlines/airports). Airlines have a lot of dwell time, which airports do not. Airports have space, which airlines do not.