

A STRATEGY FOR SUSTAINABILITY FOR
SMALL NATIONAL AIRPORT SYSTEM AIRPORTS

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PRESENTED IN FULFILMENT OF THE MANAGEMENT PAPER REQUIREMENTS
of the
INTERNATIONAL ASSOCIATION OF AIRPORT EXECUTIVES CANADA

Date 96/01/29

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INTRODUCTION

In July 1994 the Honourable Doug Young, Minister of Transport for Canada announced a National Airports Policy (NAP) which significantly changed the way airports in Canada would be owned, operated, and funded. For over 60 years prior to 1994 the federal government had assumed increased responsibility for airports with no apparent consistency or focus on a clearly defined system or role to guide those decisions. Over the years the government assumed a wide variety of roles related to airport operations, including airport operator, financier, landlord, regulator, and advisor, with the result that imbalances of funding and facilities occurred across the country. This new policy changes the role of the federal government at all Canadian airports by relinquishing its role as operator and financier of the airports. The most significant change is in the area of financing of airports, particularly those which have been dependent on the federal government for financial operating and capital shortfalls. This aspect of the National Airports Policy will be the subject of discussion of this paper as it applies to small airports in what is referred to as the National Airports System (NAS). In order to understand this issue it is necessary to first see the highlights of the new policy and review in more detail the financial framework under which airports had traditionally functioned.

THE NATIONAL AIRPORTS POLICY

The NAP provides a framework that outlines the federal government's role with airports which have scheduled passenger service. They are divided into two distinct categories: National Airports System and Regional/Local Airports. The NAS comprises 26 airports that link the country from coast to coast and internationally. Airports in the National Airports System are considered essential to Canada's air transportation system and are of strategic importance in maintaining Canada's economic competitiveness domestically and world-wide. The NAS includes airports in all national, provincial, and territorial capitals, as well as airports with annual traffic of 200,000 passengers or more. At the time of the policy announcement, the 26 NAS airports served 94 per cent of all scheduled passenger and cargo traffic in Canada.

The federal government will retain ownership of the 26 airports identified as part of the National Airports System; however under the NAP they will be leased to Canadian Airport Authorities (Authorities), local entities that will be responsible for financial and operational management.

The other category of airports established under the NAP are the Regional/Local Airports; those which serve scheduled passenger traffic, but handle fewer than 200,000 passengers each year. Ownership of these airports will be offered to provincial and local governments, airport commissions, private businesses or other interests in that order. New owners will be free to establish owner and management arrangements best suited to the community's needs.

The federal government will remove its operating subsidies from airports in both the NAS, where applicable, and Regional/Local categories over a five-year period which began April 1, 1995. To that end all airports which are being subsidized are to take measures to reduce the deficit, such that it would be eliminated progressively each year for five years, when the airports are to be self-sufficient.

For Regional/Local airports an Airport Capital Assistance Program (ACAP) will be introduced. This program will provide financial assistance for safety related airside capital projects, such as runways and taxiways. It will be funded in part, by the lease revenues from National Airports System airports.

TRADITIONAL FUNDING ARRANGEMENTS

Virtually all airports in Canada are owned and operated by the federal government and rely on votes of Parliament to provide the required funding on an annual basis. Unlike some sectors of government that produced no revenue, all airports produce some revenue through the imposition of fees, charging of rent and user fees; although it is only the largest airports in the system which show an overall profit or positive bottom line. This revenue is grouped together and is applied toward the operating costs of airports with the result that the operating department, Transport Canada, is voted the difference between costs and revenues in a process called Vote Netting. The funds provided by Parliament are distributed through the department to the various regions and major airports. Funds are divided and distributed through Regional Directors General to operate the smaller or Federally Dependent Airports.

Capital Funds are provided by Parliament for airports of all sizes and distributed in essentially the same fashion as operating funds. At one time operating funds were tied into associated capital projects ensuring that O&M funds would be available if the new capital project were approved. Each capital project is prioritized on a regional and national basis with funding being made available on a top down priority basis.

Funds under traditional methods were relatively easy to obtain, and in fact, funding kept up to inflation through documentation of cost increases and increased benefit packages for employees. In recent years governments in general have been faced with higher deficits, resulting in more pressure on available funds and reducing funds being made available to sectors of government, including airports. With these reduced funding levels, airports found it increasingly difficult to operate, however; no matter how difficult it seemed, the federal government was always there for support, and ultimately funding.

This is where the big change occurs. No longer will the federal government be the source of funds and the provider of service. Airports must become self-sufficient. For those airports known as Major Federal Airports, such as Pearson International Airport, Halifax International Airport, and Ottawa International Airport, self sufficiency is not a significant issue when compared to the smaller airports at the other end of the NAS scale.

There are essentially three ways any business entity, including airports, can become financially self sufficient: they can increase revenue, they can decrease costs or apply a combination of revenue increases and cost decreases. This latter option is the logical and preferred way in reaching self-sufficiency. As we continue on this exercise, reference will be made either directly or indirectly to Charlottetown Airport, a small airport in the National Airports System.

Charlottetown Airport is one of the smallest airports in the National Airports System in terms of passengers, aircraft movements, and revenue. The ratio of revenue to operating and maintenance costs in the year just prior to the implementation of the National Airports Policy were \$2.4 million with a revenue base of \$1.2 million. To reach a break-even position on O&M costs vs revenue is a major challenge at an airport of this size.

It is proposed to deal with cost cutting measures first, followed by a review of ideas that will lead to increased revenue and ultimately measures to close the financial gap.

COST REDUCTION

To make NAS airports attractive to the Authorities, the federal government has directed that each airport prepare a Transition Plan that will move each airport toward operational and capital self sufficiency within five years starting 1 April 1995. To enable readers to visualize the extent of this exercise for an airport like Charlottetown, the numbers of the Financial Plan, contained in the Transition Plan are presented here as Table 1.

TABLE 1

Looking at the whole picture it can be seen that a zero deficit or financial self-sufficiency is not reached through cost avoidance or reduction; although operating costs

are reduced by 32.3% from Base Year to Year 5. Salary costs in that same period are reduced 38%.

Cost reductions are being introduced in a steady and cumulative manner. In the early stages of the Transition Plan, reductions are made with a minimal impact on airport users but eventually the cuts will be of such a magnitude as to attract the attention and perhaps the ire of users. The level of service in the Air Terminal Building and Airfield is a matter that will have to be addressed. The users of the airport will express their dissatisfaction in the form of complaints. The Air Terminal Building (ATB) and airfield have virtually always been open and fully functional; the exception being during extreme weather conditions, which have resulted in short and infrequent disruptions of service.

The airport has had a series of consecutive funding reductions in the past five to eight years, and further reductions over the next five years are necessary. The result will be felt throughout the organization. They include reductions in terminal service and contracted services such as the functions carried out by Corps of Commissionaires. The plan calls for a significant reduction in human resources and there will be an increased need to contract some services, putting an increased demand on the non-personnel funds in this area. Looked at together, the reduction in both personnel (p/ys) and non-personnel resources is not seen as achievable without considerable impact at the end of Year 5. The cutbacks are based on the following premises and result in the following impact:

Cuts will be made at all levels of the organization and include managers, supervisors, and working level employees. The number of managers reporting to the Airport Manager will be reduced from three to one, and the number of supervisors will be reduced from four to one, effectively reducing the number of employees in each of Building, Electrical, and Mobile Maintenance sections from two to one. At the same time, reductions will be made in the administration area, from three clerks to two and the fire hall staff will go from a level in 1994/95 of nine to five in 1997/98, with the arrival of a new emergency response vehicle, and to four in 1999/00. These cost reductions, while they will have some impact, are not seen as being critical. All light vehicles be sent to outside service centres for maintenance, and repairs to heavy equipment, particularly during the winter months, will require a longer down time with just one person working on the repairs. We have not cut back the number of full time heavy equipment operators and the number remains at three; however we will be required to cut back on winter help. Currently and in previous years we have utilized three crews of four, to provide coverage of sixteen to seventeen hours per day, seven days a week. With the new staffing level of eight, we will be forced into providing coverage with two crews of four. Two crews of four will provide sixteen hours of coverage seven days a week with four of fourteen shifts operating with two, eight shifts of three and two shifts of four, and utilizing overtime to supplement the crews of two and three - when required. If overtime was not available we

would resort to a five days per week or attempt to maintain seven days per week knowing that there would be delays and closures depending on weather. Either option lends itself to compromise; relatively good service five days per week only or unreliable access every day of bad weather.

Another option exists for staffing during the winter months. It is conceivable the airport could operate by having a full time employee covering each shift and using term employees strictly on a call back basis. The positive side of this plan from the airport's perspective is that dollars are saved on labour; however on the down side, it may turn out that qualified personnel are not always available to respond to a call from the airport during the time of need. This arrangement would have a negative impact on the employees being called in as there is no longer a guarantee of a full work week. It is not envisaged that this option would be utilized early in the transition plan, if at all, however it is one that cannot be ignored when dollars dictate the level of service.

The single biggest reduction in non-personnel costs will come in Special Services & Fees, where the expenditures would be reduced from approximately \$250,000.00 per year to \$110,000.00 per year. The majority of costs in this reporting object at present, relate to Commissionaires at \$143,000.00 per year and a Cleaning Contract which costs about \$75,000.00. The Corps of Commissionaires provide security/information services in the terminal building, operation of the long term parking lot, revenue collection from parking meters, ramp access, and issuing of temporary passes.

Commissionaire coverage until recently consisted of three persons per day, three persons per evening shift, and two on night shift. This has been reduced to the present scenario of two on days, two on evenings, and one on nights. This staffing has been achieved by reducing the number of commissionaires looking after the information desk and providing security to one person in the ATB, instead of two. Absence from their office also results in delays in access to the ramp for those requiring the commissionaires assistance. The absence away from the telephone is compensated in part by an answering device. This represents a drop in service but nothing significant. The reduction in the night shift resulted in elimination of patrols outside the building, thus reducing our ability to maintain the same level of surveillance on properties.

The next step in this area is to reduce the night shift to zero coverage, which can and will be compensated to some degree through the installation of alarms which terminate at a message centre. Day and evening coverage could be reduced to one person per shift, except at peak periods of the year, by installing automated parking systems which do not require staffing. Presently Commissionaires are required to staff the parking booth at flight times.

Implementation of this concept is contingent on acquiring the appropriate parking control mechanisms at a significant cost; however it is anticipated that the equipment could show a return on investment after 2 1/2 years. The acquisition of this type of equipment is presently being reviewed. The biggest problems with this will occur when the equipment is non-functional, a person cannot understand how it works or the exiting user does not have any of the required methods of payment available. Not only is this person held up, but so is everyone behind him/her. Thus we have an example where Level of Service is compromised in the interest of financial expediency.

Cleaning contracts must be pared back to meet only the most basic tasks. The airport can no longer afford to have a cleaner available during all operational hours; instead, performance standards must be used which dictate a level of service to be provided by the contractor. If the contractor fails to meet requirements, he is released from the contract and if the contract price is too high, the standards and requirements set by the airport must be lowered. Standards will be gradually reduced to meet the minimum standards acceptable to users. Complaints will no doubt follow, but there are few options.

The next largest expenditure at this airport is for municipal and public utility services. It is not seen as being practical to reduce much further our electrical or water consumption, unless we take the very drastic step of closing the air terminal building to operate under a much reduced operating day. For the purposes of this exercise the reduction in utility costs was shaved marginally as we have previously taken all steps that we can to reduce consumption both in electricity and water. We are showing a reduction in fuel consumption consistent with a reduced operating day, both in the terminal and on the airfield. Additional reductions cannot be made without further closing the operating window at the airport.

Every effort has been made to reduce costs in all areas of the operation. It is evident that the traffic volume at Charlottetown running roughly just under 200,000, is not able to support the type of operation that would provide anywhere close to the same level of service that we have provided in the past.

Comparison of expenditures by Reporting Objects (R.O.)
1994/95 - 1999/00

\$000

\$000

<u>R.O.</u>	<u>ACTUAL</u> 1994/95	<u>YEAR 5</u> 1999/00
Travel Expenses	20.0	8.0
Postage/Freight	12.6	4.0
Telephones	15.6	10.0
Advertising	0.6	1.0
Publications	2.0	1.0
Professional Services	14.7	6.0
Training	5.8	2.0
Operating Services	0.0	0.0
Special Services	254.7	110.0
Rental equipment	6.7	4.0
Repairs	34.3	40.0
Machine repairs	31.8	35.0
Fuel	101.0	85.0
Utilities	152.5	140.0
Parts/Accessories	106.4	75.0
Small tools/equipment	93.4	60.0
Office materials	9.1	4.0
Food/supplies	0.0	0.0
Equipment over \$1,000.00	2.2	0.0
Other expenses	<u>0.1</u>	<u>0.0</u>
	863.5	585.0 = 32.2% reduction

Cuts of 40.0 % in the personnel area and 32.2% in the non-personnel area have been proposed over the next 5 years, for the period ending 1999/00. Under this scenario funds would be allocated for only the absolute essentials and the level of service will be such that complaints can be expected to be received on a regular basis.

The statistics and scenarios above are provided to give readers insight into the cost reduction measures that are required to work towards self-sufficiency. They are based on the assumption that the organization will have the flexibility to interchange duties among employees and that eventually the airport will not be reliant on cumbersome national systems to carry out the financial and personnel details of the business.

It should be pointed out that the figures provided do not include all costs associated with the operation of an airport. They do not include the overhead

costs associated with providing services such as accounting, auditing, engineering, and insurance. The federal government does not carry insurance as it is "self assuring". This cost will be assumed by the Airport Authority as will the other overhead costs which have been carried out and borne by the National & Regional headquarters of Transport Canada. Obviously there are no overhead costs to reduce from an airports existing operating budget, as they are not a cost of the airport, so the money will have to come from revenues generated by the airport in the future.

This outline so far has been presented to give the reader a brief summary of the airport's past, its operating method, and the reduction in costs seen as the most that can be reduced in an effort to meet the goal of financial self sufficiency.

TRADITIONAL SOURCES OF REVENUE

Revenues at a small National Airports System can typically be divided into five main groups. National Fees make up about 43% of the total yearly revenue are comprised of landing fees and general terminal fees. These fees are set on a national basis and apply at all Transport Canada airports. There is no flexibility provided to individual airports to adjust these fees to reflect various marketing incentives. Rentals consisting of rent payments for the use of land, office space, and systems such as Flight Information Display System and Public Address System, account for 20% annual revenue. Concession Fees are the greater of, a minimum guarantee or a percentage of gross revenue which flows to the airport from such services as car rentals, restaurants, advertising, and telephones. Concession fees account for 18% of revenue. Car Parking short & long term, employee parking, and Ground Transportation fees account for 14% of revenue. Miscellaneous revenue makes up the final group, 5% generated from such sources as aircraft parking, sale of utilities, and other recoverables. In working toward a "balanced budget" it makes sense to look at these traditional sources of revenue with a view of finding methods of increasing the amounts of revenue received.

Land Airport Land is probably the largest untapped asset for most small airports today. This asset represents a very real opportunity to generate significant new airport revenues. Undeveloped real estate can be converted into multi-cargo buildings, small aircraft hangars (T-hangars), industrial parks, recreational facilities such as golf courses or driving ranges, hotels/motels, gas stations, and the like. More and more emphasis must be put on these revenue generation opportunities by developing and marketing airport property.

From the point of view of a potential developer of airport land, investment capital can be invested into property improvements as opposed to buying expensive tracts of land. The down side of this transaction for the developer is that the improvements will ultimately revert to or vest with the airport. Careful thought and planning is needed to market and develop the land, select the appropriate tenant and negotiate the type of lease that mutually benefits both parties. Under the Airport Authority concept, a local Board of Directors could offer incentives in the form of low front end lease rates to make the business start up easier and more likely to succeed in the critical early years.

By encouraging private developers and businesses to invest in and improve vacant portions of airport land, the airport receives additional revenue and contributes to the overall "critical mass" which is required to ensure a growing and vibrant airport. It also has the effect of cost avoidance in that maintenance costs and tax burden are transferred from the airport to the lessee.

Some airports may be surrounded with more land than can reasonably be used or developed for some of the uses suggested, but could be used for agricultural purposes. Rates again are based on market value. One of the best ways to determine what rate to assess agricultural land is by calling public tenders for the use of the land. Leases should be prepared to protect the airport from unnecessary and unsafe intrusion onto aircraft manoeuvring areas and to preclude the growing of certain bird attracting crops, such as corn, on the runway approaches. Leases should be prepared for periods of 5 years to allow proper crop rotation and thus protection of the land.

The same philosophy of flexibility can be applied toward the rentals of existing space, whether within an Air Terminal Building or other buildings which are airport owned. While the concept of applying market rates to existing properties should apply, flexibility can and should be exercised in rate applications to entice and encourage prospective tenants to establish on the airport.

Concessions Airports with few, if any, connecting passengers are at a disadvantage with respect to having captive passengers with potential purchasing available passing through the terminal. Passengers at predominantly originating-destination (OD) airports, which is the case at Charlottetown, spend less time at the airport than do passengers at enplaning-deplaning (ED) airports. The OD airports are quite often small airports and because of their size, passengers know that lineups will be minimal and processing times are considerably less than at larger airports. This shorter period of time presents somewhat of a challenge to airport management to attract viable tenants/concessionaires who are able to

realize a reasonable profit which contributes to the overall benefit of the airport operation. Notwithstanding the drawbacks, these are a few incentives that can be developed to assist concessionaires.

We have all heard that the three most important factors affecting retail shops are location, location, location. However, sales in a shop can be severely restricted by poor merchandising, high prices, reduced hours of operation, or the attitude of sales personnel, even if the location is ideal. The following factors will affect the operational success of a retail shop.

Location: A large percentage of airport passengers and even well wishers are impulse buyers. If shops are located adjacent to traffic flows in areas where potential consumers experience waiting time, such as holdrooms, the participation rate and subsequent sales will be significantly higher than if the same shops must be sought out.

It is also true that where shops are clustered in highly visible locations, the combined sales volume is greater than if the stores were located apart from each other.

Recognized Brands: The trend today seems to be towards national or strong regionally recognized operators. Such retailers have developed standards for quality, level of service, prices and satisfaction, which they apply whether the outlets are located in a very large market or a small airport. Customers get to know brand names and have come to expect a consistent product regardless of geographic location. It is suggested that airport management make every effort to point out the benefits to these retailers of setting up shop in their airport terminal.

Kiosks: One trend that is developing at airports large and small, is the use of kiosks to market products of all descriptions. Kiosks are small, they are mobile, they can be built quite cheaply and can be very attractive. They can be used to merchandise everything from sunglasses to ice cream and can even be used on a seasonal basis. The option could exist for the airport to build the kiosks and have the retailer decorate appropriately to suit his product or company image, or the retailer could provide his own kiosks.

Prices: National or strong regional branded operators are seen to be effective in ensuring that products and prices are perceived to be and in reality reflect a good value for money. Lease documents should refer to pricing controls that are tied to local market prices in the adjoining retail area. The airport operator should expect to receive a reasonable rent, not one that forces the

operator to charge exorbitant prices. In this way both the airport operator and the concessionaire are in "win-win" positions.

Car Parking: Parking fees are a good source of revenue. Rates should be adjusted to reflect those in effect in the surrounding area. Care should be given to ensuring that the long term rates for extended periods do not force users to make alternate arrangements and deprive the airport of revenue. A review should be made of the cost of collecting vehicle parking revenue and consideration should be given to the acquisition of control equipment which does not require parking lot attendants. The cost of such equipment varies from \$15,000.00 to over \$100,000.00, however if the payback time is 2-3 years, the net gain is worth the one time expenditure.

Notwithstanding the very best efforts of an airport to minimize costs and increase revenues from traditional sources, inevitably, small NAS Airports will be left with a financial shortfall. Should revenues be matched to operating costs or vice versa, two major expenses remain which require funding, overhead charges and capital expenditures. Under the present regime these two costs are absorbed by Transport Canada, and are the two components which lead to the financial shortfall. In the case of Charlottetown Airport, that figure is in the \$1.2 million range or approximately \$12.00 per enplaned passenger.

Local Planning Groups at airports are at various stages of expression of interest and review relating to the transfer of their communities' airport to an airport authority. The federal government's policy regarding make up of airport deficits does not include any access to a Capital assistance plan similar to what is available for regional/local airports. It is obvious that small National Airports System airports must have a means of funding. The suggestions that follow are intended to provide avenues of relief to those airports. Not all airports included in the NAS would necessarily require access to such a fund, but it is abundantly clear after careful study of a small NAS airport that they can not, nor should not be included as one of a group of 26 airports each capable of being or becoming financially self-sufficient. A review of the NAS airports would appear to support the idea of those airports with enplanements in the range of greater than 250,000 to 300,000 could be in break even positions. All other NAS airports are most likely incapable of operating without some form of financial injection.

This problem is not peculiar to Canadian Airports. In Janes Airport Review July/August 95 it is stated that the most immediate problem facing US airports is the fate of the Airport Improvement Program (AIP), which has sent some \$16 billion in federal grants to more than 200 airports since the program was approved

by the US Congress in 1982. Annual funding peaked at \$1.9 billion in 1992, dropped to \$1.45 billion in FY95 and now may be facing extinction as Congress moves toward more extensive budget-cutting. About half the AIP funds allocated have been spent on terminals and airport access programs, with another 25% going to pay bond interest.

Under the National Airports Policy the Minister of Transport will establish the Airports Capital Assistance Program (ACAP) to help regional/local airports with scheduled passenger service finance safety related airside infrastructure projects such as runways, taxiways, etc... It is recognized that passengers originate and/or conclude travel at regional/local airports which in turn contribute to the revenues of larger national or international airports as they pass through these larger facilities. The ACAP provide an indirect means of returning revenues to the regional/local airports from lease revenues paid to the federal government by Canadian airport authorities operating in the national airports system.

In the Canadian scene the inclusion of small NAS airports as participants in the Airport Capital Assistance Plan (ACAP) is seen as a logical and readily available solution to the capital funding problem. It would require a larger amount of money than was planned if only regional/local airports were included in ACAP.

Amendments to the National Airports Policy to allow small NAS airports to participate in the Airport Capital Assistance Plan would recognize that these airports also contribute to the passenger volume and ultimate profitability at larger national and international airports whose lease payments are the basis of funding for the ACAP.

Another source of revenue is the Passenger Facility Charge (PFC), a fee added to the price of a ticket or collected independently by the airport authority. The US has regulations governing the approval, collection and use of PFC's. Approval to collect a PFC must be obtained by the FAA on a case by case basis. They are collected to finance airport related projects and expire when the project is completed. The maximum PFC in the US is \$3.00 per airport and the maximum charge to the traveller on any one trip is \$12.00. PFC's are utilized in Canada now at Vancouver International Airport and Edmonton Municipal Airport, to name two, and range in amounts from \$5.00 to \$15.00. These charges could be assessed at NAS airports and depending on the decision of the Authority, use the monies collected to fund the ongoing operation, if necessary, and to fund individual projects. Unlike the US, Canada has no legislation or regulations in place governing the collection or use of PFC's. Airlines are not required to collect the charges on behalf of airports, therefore; unless there is agreement from airlines

to collect PFC's, each airport would be required to devise a means for this collection. Community support should be obtained, prior to implementation of the PFC, or as a minimum, the rationale for the imposition of a PFC should be widely promulgated. Nobody likes paying more money than necessary, but an amount of \$10.00 - \$15.00 added to a ticket price of \$300.00 and up soon gets absorbed into the total.

On the broad question of airport funding in Canada, the airline industry has taken the position that revenues generated by the large airports must be returned to the aviation system and to the smaller airports in the form of assistance to meet their financial shortfalls. The federal government on the other hand argues that Canadian tax payers, who have invested hundred of millions of dollars into the system are entitled to a return on their investment. The airline industry maintains that the system was built on taxes we have already spent for development purposes and asking for a return of contribution is akin to double taxation, a form of taxation that is not applied equally to all modes of transportation.

Canadian Airports may have to resort to the type of financial management that exists at most air carrier airports in the United States.

OTHER APPROACHES TO FINANCIAL MANAGEMENT

At most commercial airports in the United States, the financial and operational relationship between the airport operator and the airlines is defined in legally binding agreements that specify how the risks and responsibilities of running the airport are to be shared. These contracts, commonly termed airport use agreements, establish the terms and conditions governing the airlines' use of the airport. The airport use agreements specify the methods for calculating the rates airlines must pay for use of airport facilities and services; and they identify the airlines' rights and privileges, sometimes including the right to approve or disapprove any major proposed airport capital development projects.

Although financial management practices differ greatly among commercial airports, the airport-airline relationship at major airports typically takes one of two very different forms, with important implications for airport pricing and investment:

1. The residual-cost approach, under which the airlines collectively assume significant financial risk by agreeing to pay any costs of running the airport that are not allocated to other users or covered by non-airline sources of revenue.

2. The compensatory approach, under which the airport operator assumes the major financial risk of running the airport and charges the airlines fees and rental rates set so as to recover the actual costs of the facilities and services that they use.

THE RESIDUAL-COST APPROACH

A majority of the large commercial airports of the US have some form of residual-cost approach to financial management. Under this approach, the airlines collectively assume significant financial risk. They agree to keep the airport financially self-sustaining by making up any deficit (the residual cost) remaining after the costs identified for all airport users have been offset by non-airline sources of revenue (automobile parking and terminal concessions such as restaurants, news stands, snack bars, and the like). The difference between costs and revenues provides the basis for calculating the rates charged the airlines for their use of facilities within a cost centre. Any surplus revenues would be credited to the airlines and any deficit charged to them in calculating airline landing fees or other rates for the following year.

THE COMPENSATORY APPROACH

Under a compensatory approach, the airport operator assumes the financial risk of airport operation, and airlines pay rates and charges equal to the costs of the facilities they use as determined by cost accounting. In contrast to the situation at residual-cost airports, the airlines at a compensatory airport provide no guarantee that fees and rents will be sufficient to allow the airport to meet its annual operating and debt service requirements. For each cost centre, a calculation would be made of the total annual expense of running the centre, including administration, maintenance, operations, and debt service. The airlines' shares of these costs would then be based on the extent of their actual use of facilities within each cost centre. The airlines would not be charged for the cost of public space, such as terminal lobbies. They would not receive any credit for non-airline revenues, which offset expenses in the residual-cost approach but are disregarded under a compensatory approach in calculating rates and charges to the airlines.

MAJORITY-IN-INTEREST

In exchange for the guarantee of solvency, airlines that are signatory to a residual-cost agreement often exercise a significant measure of control over airport investment decisions and related pricing policy. These powers are embodied in so-

called majority-in-interest clauses, which are a much more common feature of airport use agreements at residual-cost airports than at airports using a compensatory approach.

Majority-in-interest clauses give the airlines that represent a majority of traffic at an airport the opportunity to review and approve or veto capital projects that would entail significant increases in the rates and fees they pay for the use of airport facilities. Although most airports have at least a small discretionary fund for capital improvements that is not subject to majority-in-interest approval, the general effect of majority-in-interest provisions is to limit the ability of the public airport owner to proceed with any major project opposed by the airlines.

The final decision as to which, if either, of these approaches to financial management is adopted in Canada will probably rest initially with the airlines as represented by their association Air Transport Association of Canada (ATAC) and Transport Canada.

Preliminary negotiations have taken place between Transport Canada and ATAC with a view of reaching agreement on financing of Canadian Airports, particularly those which have been traditionally dependent upon the federal government to cover operating deficits, not to mention capital funding. There is a strong resistance by airlines to add incremental charges to the cost of the passenger ticket. Additional pressures will be exerted on airport operators to reduce and eliminate costs which are not seen by the airlines as necessary for the airport to operate. Once the funding parameters are worked out by the airlines, through their Association and Transport Canada, the onus will shift from Transport Canada at the national level, to the airport manager at the local level and the various user airlines.

Financial self-sufficiency of small airports will not be accomplished easily or without some very basic changes in attitudes and financial practices. There are not a lot of options available to resolve these differences, but one option that is not acceptable is the status quo. The airport, the airlines, and the community would all be non-winners, so solutions must be found.

CONCLUSION

In summary, it is evident from the review of the numbers that even with the most stringent of cost cuts, and the most optimistic application of revenue increases from traditional sources, a large gap exists between income and costs. I have attempted to show where costs could be reduced through changes in operating practices and by adjusting the levels of service provided. An effort was also made to point out some changes in marketing practices which would lead to revenue increases, from the traditional sources. In spite of the best efforts of airport operators, a significant shortfall will continue to exist. This shortfall can be met in any or all of four distinct ways:

1. Small NAS airports become participants in and beneficiaries of the Airport Capital Assistance Program.
2. Passenger Facility Charges are introduced to cover, where necessary, both operating and capital shortfalls.
3. Some form of financial management agreement be reached between airports and use airlines.
4. Arbitrary imposition of increased user fees to reach a balanced budget.

The last option is suggested only as a last resort and possibly even a non-starter because as user fees increase, airlines will minimize their operations, perhaps even curtail service if passenger demand falls to reflect increased ticket costs. It is therefore in the best interest of all parties, the airport, the airport authorities, the airlines, the users, the community and the federal government that solutions be reached. It will require a new outlook by all parties concerned. It must and can be done.

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