



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** William F. Sherry, A.A.E.

**SUBJECT:** REVISIONS TO AIRLINE AIR  
SERVICE INCENTIVE PROGRAM

**DATE:** May 12, 2008

Approved

Date

5/19/08

**COUNCIL DISTRICT:** Citywide

## RECOMMENDATION

Adoption of a resolution revising the airline air service promotional fee-waiver incentive program to support the development of new and added air service at the Norman Y. Mineta San José International Airport, by providing incentives for underserved long haul domestic markets, and an increased incentive for unserved Trans-Atlantic and/or Trans Pacific Air Service and long haul domestic flights, and repealing Resolution No. 73212.

CEQA: Resolutions No. 67380 and 71451, PP 08-059

## OUTCOME

The revised airline incentive program can provide the City with an effective tool to help secure new air service. It will help reduce an airline's financial risk during the important start up period. Further, adoption of the program will demonstrate San José's commitment to partnering with airlines.

## BACKGROUND

Norman Y. Mineta San José International Airport is a strategic asset in achieving the City's economic development goals. Air service provides an essential link to support the economy and to sustain the region's quality of life by moving people and products between San José and destinations globally. Access to domestic and international markets is a priority of the region's businesses. As noted during public meetings and from feedback received through the Airport's outreach programs, community and business leaders have expressed a strong desire to improve access from San José to key domestic and international cities.

During the last several years, San José has experienced a significant reduction in the availability of domestic and international air service. The well-documented struggles of the aviation industry, including increased fuel costs, along with the slow economic recovery of our region, have made securing new service a challenge.

With the airline industry now in a period of uncertainty due to the ever increasing fuel costs and a weakened economy, airline route planning decisions are focused more than ever on establishing and maintaining route profitability. An airline's decision to serve a new market represents a significant investment and financial risk to the carrier.

In 2006, the City Council approved the current incentive program which waived aviation fees for one year for all new unserved international and domestic flights on the list of cities/airports qualifying for Air Service Incentives.

### **ANALYSIS**

Since its adoption in the summer of 2006, only Frontier Airlines' service to Cabo San Lucas qualified for the waiver from March 3, 2007 until its cancellation in early January 2008.

Recognizing how difficult it has been to add new cities as well as add service to cities with minimal air service, staff is proposing revision to the program to allow for a longer waiver term based on the length of flights. In today's \$110+ per barrel of oil setting, the City needs to increase our support for longer flights as the airlines risk has been increased substantially in the last six months due to rise in fuel costs (perhaps as much as 75%).

The revised airline incentive program for Mineta San José International Airport will help reduce an airline's financial risk during the important start up period. Further, the revised airline incentive program will demonstrate San José's commitment to partnering with airlines.

When faced with a choice on where to place additional air service, airline incentive programs can be a determining factor in the airline decision-making process. Other market factors that influence an airline's decision to invest new air service in a community include route feasibility forecasts, aircraft availability, market competition, airport costs, and the level of support an airline will receive from the community. Airline route planners give particular attention to those communities that effectively partner with carriers and maintain a business-friendly environment at airports.

The proposed revisions to the incentive program provide for the creation of three different incentive categories based on stage length of flights and graduated promotional periods:

#### **Category 1:**

All new non-stop, short haul year round domestic flights to cities such as Albuquerque, Tucson, Spokane, Eugene, San Antonio and short haul international cities, such as Vancouver, Calgary and unserved cities in Mexico would qualify for a one year waiver of all variable fees, including landing fees, ticket counter charges, baggage claim fees, gate use fees, aircraft parking charges

and airport imposed international passenger processing fees (excluding Passenger Facility Charges).

**Category 2:**

All new non-stop medium range year round domestic flights to unserved East Coast cities such as: Philadelphia, Orlando, Raleigh Durham, Toronto, Miami, Ft. Lauderdale, Detroit, new Hawaiian unserved cities, and new non-stop service to the underserved cities of New York, Boston, and Washington would qualify for a two year waiver of all fees identified in category 1. All fees would be waived for the first year, and fifty percent (50%) of the fees would be waived for the second year. Currently, Airport staff considers "underserved markets" to be New York (Kennedy and Newark), Boston and Washington. These cities should continue to be considered as underserved until there are three daily non-stop flights throughout the day.

**Category 3:**

All long haul year round international flights to/from Europe and Asia would qualify for a three year graduated waiver program. As a nonstop flight to London or Tokyo represents over 20 hours of flying roundtrip and requires two aircrafts per mission, staff feels that an extended waiver is warranted. All fees highlighted in Category 1 would be waived 100% in year 1, 66% in year 2, and 33% in year 3.

All airlines – including both new and incumbent carriers – would be eligible to participate in the proposed program. To receive the fee waiver credits, the airline must agree to begin new or added non-stop service between San José and a qualifying domestic or international city. During the 12 month, 24 month, or 36 month promotional period (depending on category), incentive credit would be offered to all carriers who operate new (or added flights to underserved airports) non-stop service between San José and the qualifying city's airport.

The program objective is to obtain convenient non-stop access to key domestic and international destinations. International air service is a catalyst in Silicon Valley's ability to compete globally. The Bay Area Economic Forum recently noted that the region's economy has grown more dependent upon international trade. Nearly half of the region's exports go to Asia (46%), 24 percent go to Canada and Mexico, 23 percent to Europe, and 7 percent to the rest of the world.

Air service that is operated within the Airport Curfew hours of 11:30 p.m. to 6:30 a.m. will not be eligible to receive incentive credit except for those operations that were beyond the operators control such as weather, air traffic, or mechanical delays prescribed for in the City's Curfew Ordinance.

Fees and charges do vary according to the business needs of each carrier. However, the Airport could receive approximately \$400,000 in fees annually for a typical domestic flight that is operated on a daily basis. For each daily transoceanic flight, the Airport could receive an estimated \$1 million annually in fees and charges.

Introducing new air service to a community has an immediate positive effect on the community. Hotels, restaurants, ground transportation providers, rental car companies and area businesses all receive economic benefit from new air service. Also industry estimates have concluded that, typically for each new transoceanic air service route that is introduced to a community, hundreds of millions of dollars are contributed to the local economy annually.

It is important to note that, although the proposed program will waive the above mentioned variable Airport fees and charges for qualifying new or select added non-stop services during the term of the promotional period, the new air service will stimulate additional revenues from passengers who use the service, including food and beverage and retail sales, parking and ground transportation fees, and passenger facility charges. A new domestic flight could generate \$600,000 and a new international flight could generate \$1.2 million in incremental revenue for the airport easily offsetting the waived fees. Service credit will not be extended to an airline that within the promotional period eliminates non-stop service from another San Jose city pair. Hence, the incentive flight needs to be incremental and not replacing another SJC flight by the subject airline that is being cancelled to provide the aircraft time for the new flight.

Because of the competitive nature of developing air service, it has become a common practice for communities and airports in the United States to offer incentive programs to support air service development. Federal Aviation Administration policy allows airports to establish air service incentive programs involving waivers or discounting of fees and charges imposed on airlines in exchange for new service, as long as the incentives are limited to a defined promotional period and the incentives are available on a non-discriminatory basis to all airlines that are willing to provide the same type and level of new service consistent with the incentive program. This program is designed to meet these Federal requirements and is non-discriminatory in nature.

The proposed airline passenger incentive program is one component of a larger effort to support airlines in San José. This revision has been developed over the past nine months with input from and discussions with various air carriers. Staff would like to make these proposed changes effective May 1, 2008.

Airport staff is currently working with the Office of Economic Development, the San José Convention and Visitors Bureau, and the San José Silicon Valley Chamber of Commerce to develop joint marketing programs that provide marketing and promotional support to carriers who introduce new air service at Norman Y. Mineta San José International Airport.

### EVAULATION AND FOLLOW UP

Under the proposed program, the Director of Aviation will be responsible for establishing and managing a list of qualifying cities. The list of qualifying cities may change over time; depending on market conditions; passenger data, market research, route feasibility studies. Community feedback will be utilized to determine the eligible markets. The San José/Silicon Valley Chamber of Commerce and the San José Convention and Visitors Bureau will play a strategic role to help monitor air service needs and to make air service recommendations to the Director of Aviation. The Director of Aviation will make periodic reports to Council on the status of the Airport's air service incentive program and the City's efforts to secure additional air service.

### ALTERNATIVES

The City Council may elect to not approve the proposed revisions to the air service incentive program. If Council elects not to approve the revision of this program, SJC will be at a disadvantage compared to other airports in the state and across the United States.

### PUBLIC OUTREACH

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This item does not meet the above criteria requiring special public outreach; however, the Airport Commission endorsed this revised program at its April 7, 2008 meeting with a unanimous vote of 5-0, and the San José/Silicon Valley Chamber of Commerce and the San José Convention and Visitors Bureau both support this proposed air service development program

### COORDINATION

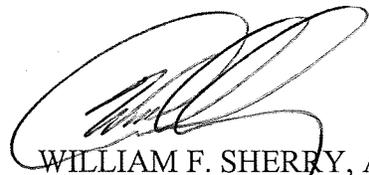
The City Attorney's Office and the City Manager's Budget Office have collaborated in the review of this revised incentive program and this memorandum.

**COST IMPLICATIONS**

The proposed airline air service incentive program credits will result in waivers of airline fees and charges for qualifying new air service. However, the increased revenue from parking, concessions and other Airport services that will directly result from the increased air service should offset any waived airline fees and charges for qualifying new service. Because staff projects that the additional revenue resulting from the increased air service will offset any waived fees and charges, no increases in airline rates and charges will be required to offset any airline fees and charges that are waived.

**CEQA**

Resolutions No. 67380 and 71451, PP 08-059



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For questions please contact William Sherry, Director of Aviation, at 501-7670.