



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

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

SUBJECT: REVISIONS TO AIRLINE AIR
SERVICE INCENTIVE PROGRAM

DATE: March 30, 2009

Approved

Date 4/6/09

COUNCIL DISTRICT: Citywide

RECOMMENDATION

Adoption of a resolution revising the airline fee-waiver incentive program to support the development of new air service at Mineta San José International Airport (SJC) by providing two-year incentives for new international routes to/from Canada and Mexico and repealing Resolution No. 74388 that established the current incentive program.

OUTCOME

The revised airline incentive program will augment the City's ability to attract new international air service by reducing an airline's financial risk during the critical start-up period, which usually is longer for international service compared to typical domestic routes. Adoption of the revised program also will demonstrate San José's continuing strong commitment to the partnership with its current and prospective carriers.

BACKGROUND

Mineta San José International Airport is a strategic asset for achieving the City's economic development goals. Air service provides an essential link to support the economy and to sustain Silicon Valley's quality of life by moving people and products between San José and destinations both domestically and globally. Gaining better access to national and international markets and technology centers has long been a priority of the region's businesses. Community and business leaders and travelers have clearly expressed their strong desire to the Airport for improved access between San José and key domestic and international cities.

Since the initial adoption of the Airport's incentive program in summer 2006, Frontier Airlines' service to Cabo San Lucas qualified for the fee waiver and jetBlue qualified with its multiple daily flights to Long Beach in May 2008. In June 2008, the City Council approved a revised incentive program that waived airline fees based on the length of the flights and authorized the Director of Aviation to designate certain key cities as underserved. Since that time, however, the

Airport has lost nonstop flights to Boston, Washington, Newark, and three additional flights to Chicago, and SJC now has just one East Coast flight.

San José has experienced a significant reduction in the availability of domestic and international air service over the last several years, but this has accelerated in the past year. The well-documented struggles of the aviation industry, including increased fuel costs last summer, the retirement of inefficient aircraft and significant reduction of system capacity, and now a severe global economic crisis, have made securing new service an even greater challenge.

ANALYSIS

Under the Airport's current incentive program, cities in Northwest Canada would qualify only for the one-year fee waiver available to eligible unserved or underserved short-haul destinations. The Director of Aviation may designate cities in Mexico as either short-haul destinations eligible for a one-year fee waiver or medium-haul destinations eligible for a two-year fee waiver. The Director of Aviation may designate other cities in Canada (other than Northwest Canada) as medium-haul destinations eligible for a two-year fee waiver.

Recognizing how difficult it has been to add new cities as well as to add service to cities with minimal air service, staff is proposing this revision to the incentive program to allow for a longer term of the waiver for all new cities in Mexico and all cities in Canada. The change would increase the period to two years, with a 100% waiver of fees in the first year, and then 50% in the second year.

New airline foreign routes normally take longer to mature, and in today's very difficult aviation market the challenge has increased. For this reason, the City can increase its offer of support for new service to Canada and Mexico, which will assist the Airport as it continues to discuss potential new routes to SJC with the Mexican airline Volaris and the Canadian WestJet. Both Volaris and WestJet are scheduled to begin "code sharing" partnership with Southwest Airlines in 2010. Southwest is SJC's largest carrier with nearly half of the Airport's flights, and code sharing will greatly enhance these foreign airlines' ability to sell international flights to new cities.

Through code sharing, the actual international flights would be flown by WestJet and Volaris, and Southwest customers could book on a Southwest flight number and continue to receive all their frequent flyer benefits and booking convenience. Likewise WestJet and Volaris customers could book flights to SJC through those carriers, and facilitate their travel to destinations beyond on Southwest flights to anywhere in the United States. This would facilitate the entry of both foreign airlines in their new market by relying on their partner's ability to handle U.S. sales.

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 (in

terms of sales) an airline will receive from the community. Airline route planners give particular attention to those communities that will effectively partner with carriers and that maintain a business-friendly environment at their airports.

With the changes recommended by staff, the revised incentive program will provide the following airline fee-waiver incentives:

Category 1:

All new non-stop, short-haul year-round domestic flights to cities such as Albuquerque, Tucson, Spokane, Eugene, or San Antonio would qualify for a one-year waiver of all variable fees, including landing fees, ticket-counter charges, baggage-claim fees, gate-use fees, and aircraft parking charges (excluding Passenger Facility Charges).

Category 2:

All new non-stop medium-range year-round domestic flights to unserved East Coast cities such as: Newark, Boston, Washington, D.C., Philadelphia, Orlando, Raleigh Durham, Miami, Fort Lauderdale, Detroit, new Hawaiian unserved cities, ***new cities in Mexico and Canada***; and added service to the “underserved markets” of New York City, Boston, Washington, and Chicago, 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 of the fees would be waived for the second year. The Director of Aviation will continue to designate New York City, Boston, Washington, and Chicago as underserved until there are three daily non-stop flights to each underserved airport on the East Coast and seven daily flights to Chicago, matching the level of SJC service in April 2008.

Category 3:

All long-haul year-round international flights to/from Europe and Asia would qualify for a three-year graduated waiver program. All fees identified in Category 1 will be waived 100% in the first year, 66% in the second year, and 33% in the third year.

All airlines – including both new and incumbent carriers – are eligible to participate in the incentive 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 one-year, two-year, or three-year promotional period (depending on category), incentive credit would be offered to all carriers that operate non-stop service for new routes between SJC and unserved destinations or additional flights to underserved cities.

Any flight proposed to be scheduled within the Airport curfew hours of 11:30 p.m. to 6:30 a.m. would not be eligible to receive incentive credit.

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.

Although the incentive program waives variable Airport fees and charges for qualifying new non-stop flights during the term of the promotional period, all new air service will stimulate additional Airport revenues by increasing passenger traffic through greater Airport restaurant and retail sales; parking, rental car, 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, which will offset the waived fees. Service credit will not be extended to an airline that eliminates non-stop service from another San Jose city pair within the promotional period. The incentive flight needs to be incremental increase in service and not replace another SJC flight being cancelled by the carrier.

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. Recently, Dallas/Fort Worth Airport revised its incentive program to triple incentives for landing fees and increase the airport's marketing support for new long-haul international services up to \$5 million per new route. 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 provide the same type and level of new service. The SJC program meets these federal requirements.

The SJC airline incentive program is one component of a larger ongoing effort to support airlines in San José. Airport staff also continues to work closely with the Mayor's Office, Office of Economic Development, San José Convention and Visitors Bureau, and San José/Silicon Valley Chamber of Commerce to develop joint marketing and business outreach programs that will provide support to carriers introducing new air service at Mineta San José International Airport.

EVAULATION AND FOLLOW UP

Under the revised program, the Director of Aviation will continue to be responsible for maintaining a list of qualifying destinations for the incentive. This list may change over time depending on market conditions, passenger data and market research, and route feasibility studies. Community feedback will be used to determine the eligible markets, and the San José/Silicon Valley Chamber of Commerce and San José Convention and Visitors Bureau also will help monitor community and business air service needs and 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 choose to not approve the proposed revisions to the air service incentive program or to alter the recommended terms of the program. If Council does not approve revision of this program, new service to Northwest Canada will continue to be eligible only for the one-year fee waiver available to qualifying short-haul cities.

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. The Airport Commission reviewed the revised program at its March 9, 2009 meeting, and voted to recommend the proposal to the City Council. The San José/Silicon Valley Chamber of Commerce and the San José Convention and Visitors Bureau both support the proposed revision to the SJC air service development program

COORDINATION

The City Attorney's Office has collaborated in the development of this revised incentive program and the City Manager's Budget Office has reviewed this memorandum.

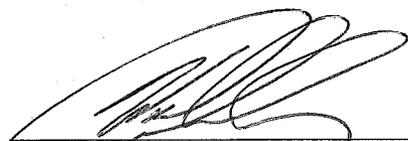
COST IMPLICATIONS

The 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 increased air service is expected to offset the short-term loss of revenue from waived airline fees and charges for qualifying new service. As a result of this anticipated additional passenger-driven revenue, no increases in airline rates and charges will be required to offset waived airline fees and charges.

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Resolutions No. 67380 and 71451, PP 09-058



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Director of Aviation

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