

Memorandum

TO: Community and Economic

FROM: William Sherry
Kim Walesh

SUBJECT: Air Service Development
Strategies for San José

DATE: January 11, 2008

Approved

Date

1/16/08

RECOMMENDATION

Accept this report on air service strategies.

BACKGROUND

At the City Council/Management Team Retreat on September 4, 2007, staff was directed to develop a private/public funding strategy and proposal targeted to promoting San José in strategic locations where we want to increase airline services, including international destinations such as Tokyo, London, and Paris, and present it to the Economic Development Committee.

This memo reviews recent efforts we have made to attract new air service, as well as the challenges and opportunities we have for developing additional domestic and international flights for San José businesses and residents. It also discusses the approaches the City, the Airport, and their community partners can take to increase flights and add destinations over the next several years.

ANALYSIS

Competitive environment

Decisions for new and expanded air service for San José are made by airlines, not by airports, using many factors in their competitive analysis. In the short term, airlines are reducing their projections for growth as they contend with the rising cost of fuel, small profit margins, stiff competition for market share, and the prospects of economic recession. This means carriers will use great caution to make major decisions to add or relocate aircraft and flights, especially in the coming year.

Long-term, projections by the industry and FAA show a significant increase in domestic and international air service demand, giving rise to industry capacity constraints for many airports over the next two decades. Fortunately, SJC currently has capacity for additional traffic, and

additional future capacity through The New Airport project is already authorized and supported by our airline partners. Policy changes, such as the recent “open skies” agreement between the U.S. and Europe, are removing regulatory obstacles to international service, and which otherwise would have hampered our ability to secure new international flights. San José will be in a good competitive position, especially in the growing Bay Area where our neighboring airports will face capacity constraints in the future.

San José is aggressively pursuing new flights and has a very strong case to make, but our efforts require long-term patience and a deliberate strategy. We must continue to establish, strengthen and maintain our relationships with current and prospective carriers by both the Airport and community leaders. As important, we must also actively engage the effective and sustained support from our community and business leaders at key opportunities in order to achieve success in the next few years.

Recent Air Service Development Efforts

Over the past year, San José has renewed its active outreach to airlines and updated our strategic goals for new service. Based on route analysis, market studies, and the Airport’s recent web survey, we see greater potential for success with currently unserved markets, such as London, Tokyo, Paris, Vancouver, Raleigh/Durham, and Tucson, and with under-served markets on the East Coast including New York, Washington, and Boston.

Airport staff has had multiple meetings with dozens of carriers, generally at their headquarters cities, to present the opportunities we offer for successful new air service in San José. These meetings have included “legacy” carriers, low-cost airlines, and new start-up ventures that are looking to serve Mexico, Asia and Europe. Although the meetings have been positive, they represent only the first steps on our long path to obtain decisions for future flights. Through these meetings we have learned about the perceptions that carriers have about San José and SJC, which enables us to hone our presentation to address the concerns that have been identified.

Challenges and strengths

Although San José has a strong story and many advantages to secure additional flights, we also face many challenges to overcome in order to achieve success. The following list summarizes our position and points to the strategies we must pursue.

<i>Challenges</i>	<i>Strengths</i>
1. <u>Conservative industry.</u> Airlines tend to make decisions that are “defensive” in nature to protect market share, and they are reluctant to become “pioneers” in selecting routes that include some uncertainties. They generally	1. <u>Silicon Valley is a global center of technology innovation.</u> Silicon Valley is recognized around the world for its entrepreneurial innovation. With scores of major technology corporations within a few

<i>Challenges</i>	<i>Strengths</i>
<p>will make “safe” decisions over those that carry the perception of uncertainty or risk.</p> <p>2.<u>High risk decisions by airlines.</u> A long-haul trans-oceanic flight represents an annual investment of up to \$50 million, and with increased fuel costs, this investment will be even higher. Return on that investment requires very high load factors in both directions. In a low-margin, highly competitive industry, airlines will locate aircraft on routes where they believe they can produce higher returns and reduce their exposure to risk.</p> <p>3.<u>San José’s weak identity.</u> Despite Silicon Valley’s strength as global technology business center, San José is not as well known by airline decision makers. In addition, San José is not generally perceived as a destination for leisure travelers compared to other cities with stronger international reputations as tourist attractions.</p> <p>4.<u>Passive community and business support.</u> Although our local community and businesses are generally supportive of the Airport and want more air service, that support is not as active or concrete as necessary to ensure the commitment from airlines.</p> <p>5.<u>Shadow of San Francisco.</u> SFO is a long-standing major international gateway that is only a 45-minute drive away from San José. As a smaller airport, SJC is not directly competing with SFO, but airlines have selected San Francisco because its reputation is stronger and is bigger, especially for international service. Airlines have clearly demonstrated that passengers from the South Bay are willing to drive to SFO because the flights are available there, and therefore from</p>	<p>miles, SJC is Silicon Valley’s airport. Silicon Valley companies also have broad business interests in Asia and Europe. Our location also draws significant numbers of business travelers, which is a positive factor for airlines.</p> <p>2.<u>Convenient location.</u> The Airport is conveniently located for Silicon Valley businesses and Downtown San José, which makes it easier for all travelers. They can save time driving to other airports in the region if flights are available at SJC. Convention participants are close to Silicon Valley meeting venues. Accessible destinations in the broader region include Carmel/Pebble Beach, Yosemite, and South Bay and Central Coast wine country, in addition to San Francisco.</p> <p>3.<u>San José and Silicon Valley population and diversity.</u> The population of Santa Clara County is remarkably diverse with strong business, family, and cultural ties to regions around the world. These are natural markets for supporting international air service, especially to Asia and Latin America destinations. The population of the market area naturally served by SJC by proximity is nearly four million, which is actually larger than SFO’s market population.</p> <p>4.<u>Silicon Valley wealth and high household income.</u> The San José metropolitan area has the highest average household income compared to any urban area in the nation. Disposable income translates to greater potential travel.</p> <p>5.<u>The New Airport.</u> By mid-2010, SJC will offer far greater efficiency and lower costs for airline operations. In addition, it will be more convenient, attractive and comfortable for passengers. The New Airport is already</p>

<i>Challenges</i>	<i>Strengths</i>
<p>an airline’s perspective, it can still serve San José from SFO.</p> <p>6. <u>SJC is seen as a “low yield” airport.</u> Even though the high proportion of business travelers using SJC means that airlines can get higher fares from our local business market, the carriers also currently have higher operating costs here. This reduces their “yield,” or profitability. Anything we can do to lower airline operating costs will help SJC become more competitive for new and expanded air service.</p>	<p>authorized for expansion to meet anticipated growth, an important consideration compared to other airports that must face complex political, environmental and community obstacles to growth. The Airport has already completed runway improvements that enhance its ability to serve long-haul routes and large aircraft.</p> <p>6. <u>New airport business model for shared use.</u> The new lease agreement between SJC and its carriers provides greater flexibility and reduces their costs for local operations and improves service and reliability for passengers. The agreement has been unanimously approved by SJC’s major airlines and took effect at the end of 2007.</p> <p>7. <u>Incentives.</u> SJC air service incentives are significant and competitive, including waiver of landing fees, collaborative marketing fund, and future passenger lounge. These incentives have been responsive to issues identified by airlines. The Airport will be making recommendations later this year to the incentive program to provide greater flexibility to meet the range of needs and opportunities we have found among airlines under the current plan.</p>

Strategic Considerations

1. We need strong, engaged, and coordinated business support

In recent discussions to explore potential SJC-Tokyo and SJC-London service, prospective airlines have asked us how much support was available from the San José/Silicon Valley business community. From the airlines’ perspective, support translates to tangible commitments from local corporations to direct their travel business to SJC carriers on new flights. This currently is an unknown element, and therefore we must consider it a weakness.

We will need to show our business community’s united, vigorous, and coordinated efforts to the airlines, especially after we have had preliminary meetings with prospective air carriers that

indicate potential interest in serving San José. Our community partners naturally must start with City Hall and the Mayor and Council, and City departments such as the Airport, Office of Economic Development, and the Redevelopment Agency. Outside of City Hall, our partners should include San José Convention and Visitors Bureau, 1st ACT Silicon Valley, San José/Silicon Valley Chamber of Commerce, Silicon Valley Leadership Group, and culturally specific business networks such as The Indus Entrepreneurs and Monte Jade.

Most important, we need to secure the active support from Silicon Valley CEOs and senior corporate executives whose companies have substantial business travel to direct their staff to use SJC flights when they are price-competitive. By working more closely with our major San José and Silicon Valley business partners, we can develop a stronger inventory of their travel needs and projections, which will be essential to secure any long-haul domestic or trans-oceanic route from SJC.

2. We must increase local business and public awareness of our efforts

At present, SJC has good working relationships with and access to corporate travel managers, but less so with CEOs and senior executives. As a key element of our strategy, therefore, we must develop stronger awareness, interest, and active engagement among the leaders of Silicon Valley companies. The City as an institution naturally has a broader reach with business and community leaders, and we must use these relationships to greater advantage through more effective coordination.

Mayor Reed is actively reaching out to CEOs, but his personal efforts will need organizational support and coordinated follow-up by both OED and Airport staff. In addition, we need deeper information about what our local companies need for their business travel, including destinations and number of trips, so that we can use that data to make our case to airline decision makers.

The economic development impact of international service is also valuable to the community as a whole, based on potential spending by travelers and businesses in the local economy. We will need to obtain an economic analysis in order to quantify these benefits of new international flights and share them with the community.

3. We must continue to be competitive with appropriate and creative air service incentives

SJC has developed financial incentives approved by the City Council that demonstrate the serious intent of the City and the Airport to become a genuine partner with carriers. However, these incentives cannot attempt to change the major financial risk involved in an airline's decision to bring a new flight to San José, which can be valued as much as \$50 million a year for a large aircraft flying between Asia and San José.

Our current incentives include a one-year waiver of aviation fees for new nonstop service and a \$250,000 collaborative marketing fund for inbound sales advertising for new service to an international destination not yet served from San José. The Airport also regularly supports the launch of new air services for Silicon Valley with local advertising in print, radio, and web

space, as we did with Horizon Airlines in 2006 for its new service to Palm Springs. Finally, the Airport has built a space in the International Arrivals Building that will be suitable for completion as a common use passenger lounge, either when we have an airline commitment for international new service or confirmation of involvement from current carriers. These incentives address specific concerns raised by MAXjet and Aer Lingus when we were discussing potential new flights with them, and they are comparable to what other airports are also offering to attract air service.

In recognition that the value of these incentives should not be “one-size fits all,” SJC is now developing a revised incentive program that would allow a longer or more flexible term for the waiver of landing fees for long flights to Europe and Asia, which are very costly for airlines to establish. In addition, the Airport is exploring potential incentives to help us attract flights to under-served destinations, especially cities on the East Coast such as New York, Washington, and Boston that our customers have already expressed great interest in having available from San José.

4. San José must develop a clearer national and international identity and reputation

Repeatedly, Airport staff meets airline executives who lack basic awareness of San José’s location, size, characteristics, and significance in Silicon Valley and the Bay Area. For this reason, these decision-makers believe that in-bound leisure travelers will be hard to attract to SJC because of San José’s weak identity and low visibility nationally and internationally.

For example, during our discussions with MAXjet and Aer Lingus in the past two years, we were told that San José is relatively unknown in Europe. This contributed to their decisions to fly to Los Angeles and San Francisco, respectively, instead of San José because they expressed doubts about their ability to sell tickets to leisure travelers coming here. Other airlines we have approached in the past year have made similar comments; while they know the significance of Silicon Valley, they don’t know the role of San José as the Capital of Silicon Valley or our geographic location.

The Airport and Convention and Visitors’ Bureau believe that OED’s work in 2007 with the Global Fluency (specialist communications firm with an international media network) has made a good start toward increasing media awareness of San José as a great place to live, do business, and visit. But, because community reputations are built and maintained over time, continuing this deliberate effort to share the achievements and character of our San José with national and international media, and therefore to potential decision makers in other regions of the nation and world, is a key part of our strategy to develop air service. The progress of building The New Airport, which will be very competitive, convenient, and comfortable for passengers and airlines alike, must be a critical part the San José story that we tell through an effective long-term, coordinated City and community communications strategy.

The Airport also wishes to work to refine and strengthen air service presentation materials that link with the City’s core messages and compelling facts and can be easily customized for different situations.

This sustained joint communications effort with targeted media, messages, audiences, and geographies should be continued in 2008. Resources can come immediately from the FY 07-08 budgets of the Airport, OED, and Convention and Visitors Bureau, with approval from Council. Over time, resources for a sustained campaign also should come from business partners who have a strong economic stake in the success of both San José and Silicon Valley's airport.

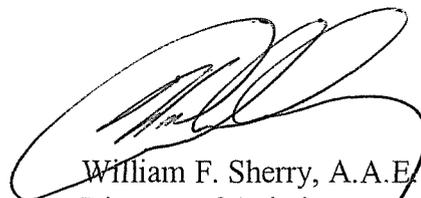
Next steps

The Airport is continuing to reach out to airlines to present our case for their success serving San José and Silicon Valley with new flights. As we make progress with our discussions with carriers, we invite them to visit San José to learn more about the opportunities here. An airline's decision to visit us is a very strong signal of interest, and such a visit to San José is likely to be the most important moment in the route analysis that will lead to a positive decision.

To have the greatest impact from these visits, we will coordinate airline meetings with our business partners and community stakeholders that will further enhance our chances of success. This means that we must take steps now to enlist major corporate and community participation at the appropriate times when we need it. Coordinated and enthusiastic support from our public and private team members at local receptions, tours, and meetings will enable an airline to meet its future customers and gauge the strength of our business commitment. It also will demonstrate that San José and Silicon Valley leadership is working together productively to embrace new air service and effectively to increase its success.

COORDINATION

This memo has been coordinated with the Office of Economic Development and the Office of the City Manager.



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Community and Economic Development Committee

Air Service Development Strategies

January 11, 2008

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