



Memorandum

TO: DRIVING A STRONG
ECONOMY COMMITTEE

FROM: Ralph G. Tonseth

SUBJECT: REPORT ON AIR SERVICE

DATE: 4/12/2004

Approved

Date

Mineta San José International Airport (SJC) is served by twelve passenger airlines, with nonstop service to 34 destinations, including Japan and Mexico. In 2003, SJC served 10.7 million passengers, with Southwest and American Airlines accounting for 60% of passenger enplanements. SJC serves a large and demographically diverse market with high levels of personal income and a large percentage of business travelers (48%) from the technology companies headquartered in Silicon Valley.

SJC has experienced a steep decline in both passenger and cargo activity since 9/11. In July 2001, SJC's share of the Bay Area passenger market was 22.9%; however, by July 2003 it had fallen to 20.1% (a 12% reduction). In the same period, San Francisco market share fell from 58.1% to 55.2% (a 5% reduction), while Oakland's market share increased from 19.0% to 24.7% (a 30% increase). The terrorist attacks and the slowdown in the regional economy, particularly the technology sector, have resulted in significant reductions in both flights and available seats. Of particular note is the loss of international service to Paris, France; Taipei, Taiwan; Ottawa, Calgary and Toronto, Canada.

The City's air service development strategy is to retain its current air service levels, while strategically pursuing the reinstatement of routes lost in the aftermath of 9/11. In addition, the City recognizes that SJC is a significant economic engine and has made the acquisition of new international routes important to support the City's Economic Strategy.

The commercial airline industry is in a continual state of flux with the financial performance of air carriers ranging from deep losses to profits, depending on a variety of corporate characteristics. Airline mergers, failures and related airline changes in market approach make establishing a consistent approach to air service development a challenge. Airports must solicit air service from carriers that have not otherwise identified their market for air service. Because of airline cut backs, the majority of airlines simply do not have the resources or staff to conduct the type of analysis that is necessary to establish new routes. Today, airports fill the gap by conducting the research airlines need to make air service decisions.

During the last 12 months, Airport staff has conducted 22 air service meetings with 16 airlines. Seven additional meetings have been scheduled during the remainder of this fiscal year.

The success of San Jose's air service program requires the Airport to continually focus on route profitability. Airlines, always conservative, are less willing and able to try speculative investments in starting air service, particularly international air service. With the industry's current financial health, they are even more discriminating.

Carriers are more likely to re-deploy their limited assets to new routes if the City can demonstrate a clear profit potential. The economic fundamentals must be clear.

The Airport utilizes market data to retain service and to gain new routes by closely monitoring airline and market performance. This includes passenger volume, schedule changes, seating capacity and feedback received from airlines. Because of the specialized nature of the data that's collected from national and international sources, San Jose uses an air service development firm in Washington D.C. Professional services are also required to handle legal proceedings to secure air service rights for international routes. As an example, San Jose relied heavily on specialized services to obtain and retain San Jose's prized Tokyo route. Obtaining route authority for international routes is a complex, and traditionally a long process. The Airport is an active member of two trade organizations that are beneficial to securing international air service: Members of United States Airports for Better International Air Service (USA-BIAS) and Airports Council International, North America (ACI-NA).

Receiving intelligence from the business community is also critical to the success of the air service program. Identifying travel trends, Silicon Valley investments overseas, and the financial performance of our local companies are indicators that are useful in identifying air service needs. The Office of Economic Development is the Airport's strategic partner in helping to obtain data to support the air service program.

Also vital in the establishment and shaping of San Jose's air service program is the input from community organizations like the chamber of commerce, convention and visitors bureau and trade organizations.

DOMESTIC AIR SERVICE

The following is a summary of recent domestic air service activity.

JetBlue Airways will begin daily nonstop service between San Jose and New York's JFK airport beginning June 10, 2004. A press conference was held March 10, 2004 to make the announcement. Efforts to recruit JetBlue Airways began two years ago when Airport staff first met with the carrier's management team. Over the two-year period, Airport staff kept in contact with the carrier by providing market research and analysis to support JetBlue's decision. Partnerships with the San Jose Silicon Valley Chamber of Commerce and the San Jose Convention & Visitors Bureau will be used to help introduce JetBlue to the community.

ATA Airlines has made the business decision to consolidate its Bay Area service to San Francisco and plans to discontinue its San Jose operations effective April 26, 2004. ATA has operated two daily nonstop flights between Chicago's Midway airport and San Jose since October 2002.

American Airlines -- will add a second daily flight between San Jose and Boston on June 10, 2004. The new flight will give American 28 flights from San Jose on peak days this summer; including nonstop service to Austin, Chicago, Dallas, Honolulu, Maui, Las Vegas, New York, Orange County and Tokyo. American's regional partner, American Eagle, will operate another 28 flights on peak days to San Diego, Los Angeles, Orange County, and San Luis Obispo. Staff met with AA's senior route management team in January to provide economic and air service updates and to solicit new air service.

Horizon Air—On April 1, 2004, service frequency between San Jose and Tucson was reduced by one; leaving one daily flight. Effective June 6, 2004, service will be discontinued due to poor performance.

Airline route planners are now showing more signs of optimism for the industry's health and are willing to consider new route opportunities. There are indications from several SJC airlines that more domestic air service may be added in the next several months.

INTERNATIONAL AIR SERVICE

Obtaining additional international air service is one of the Airport's primary goals. As reported by USA-BIAS, national studies have found that the addition of just one new transatlantic destination to a U.S. city that has little or no existing international service increases local employment by a minimum of three thousand jobs and pumps an estimated 160 million additional dollars into the local economy annually. Another similar study conducted 12 years ago found that when a single U.S. community gains daily service to a new international market, it experiences an economic gain from \$265 to \$720 million a year from the direct spending resulting from that flight alone.

The City has identified targeted destinations that are critical to the Valley's economic health. Because of the complex nature of obtaining air service, persistence is an essential requirement for success. It is not uncommon for international airline officials to overlook San Jose in their route planning sessions, often in favor of San Francisco. It's a continuous process to educate airline decision makers of the value and need to serve San Jose and Silicon Valley.

London, England remains the premier European gateway. Heathrow, Gatwick and Stansted airports serve London. Heathrow and Gatwick are the preferred airports for international network carriers. Stansted Airport, located in close proximity to London's technology region is not served by scheduled transatlantic air service. Currently there is no available route authority under the Route 1 of the Bermuda II air service agreement to designate an American air carrier to serve San Jose-London. There are however, options under the current agreement for a British

carrier to exercise, if it chooses to serve San Jose. Staff is pursuing this strategy and has met with British Airways several times during the last six months. Most recently, a meeting was held at the British Airways head office in London to educate BA route planners of the merits of serving San Jose.

Airport and OED staff continue to work together to gather data to support an airline's decision to serve San Jose-London. OED and Airport staff have also collaborated with industry leaders from the East of England, London's technology region.

Dublin, Ireland -- The U.S.-Ireland bilateral agreement provides for unlimited frequencies for a U.S. carrier from any point in the U.S. On the other hand, an Irish carrier can serve only five named points in the U.S. Aer Lingus is currently exercising its authority to serve all five U.S. gateways. The bilateral also restricts a carrier's ability to serve the preferred Dublin airport with nonstop service by requiring an equal number of nonstop flights to Shannon Airport. Due to this forced service requirement, means that a carrier wishing to start San Jose-Dublin service would have to weigh the negative consequences of having to also provide additional service to Shannon.

Staff has met with Aer Lingus management three times during the last 12 months to educate them on the merits of serving San Jose. The European Union continues its talks with the U.S. to establish a more liberal air service agreement that would enable service between the two technology regions. These negotiations are likely to be lengthy. Meanwhile, the Irish government has expressed an interest to begin discussions with the U.S. to negotiate a more liberalized agreement in advance of any EU agreement. No dates have been set to begin the talks.

Tokyo, Japan --American Airlines has operated daily nonstop service between San Jose and Tokyo (Narita) for 14 years. It is estimated this route contributes \$300 million annually to the local economy. American's San Jose-Tokyo route has remained in place despite severe circumstances including the September 11th terrorist attacks, the SARS epidemic and economic slowdowns in the U.S. and Japan. Retaining the Tokyo flight is the City's top priority.

On April 4, 2004, American began serving Los Angeles-Tokyo (Narita) nonstop. The new LAX Tokyo service could potentially affect passenger levels on the San Jose Tokyo flight. Airport staff is monitoring bookings and passenger activity to identify any adverse effects on the route. If a decline in passenger activity is experienced, a program will be initiated to partner with San Jose/Silicon Valley business and the hospitality industry to support the San Jose route.

Taipei, Taiwan—Regaining nonstop service between San Jose and Taipei is a top air service priority. As the tech economic rebounds, it is important for air service to be in place to support commerce between these two important technology centers.

In April '01, American Airlines initiated first ever nonstop service between San Jose and Taipei. The service was subsequently discontinued following September 11, 2001 due to the weakened economy. Staff continues to monitor the economic conditions and gather information to support reinstating the service. In January, staff from the Airport and OED met with AA management in

Dallas to provide updates and to discuss the strategy to reinstate the service. Further analysis will be completed and presented to American Airlines this summer.

Hong Kong is the Bay Area's second largest Asian market, second only to Tokyo. Cathay Pacific, Singapore Airlines and United provide service at San Francisco.

Under the current bilateral agreement, there is some flexibility for Cathay Pacific or American Airlines to provide new service to San Jose. In 2002, Airport staff hosted a delegation from Cathay Pacific to present data to support San Jose service. However, because of the SARS epidemic and the economic slowdown this strategy has been on hold. With conditions improving, staff met with American Airlines in January to discuss the prospects of American providing the service. Further analysis is being conducted.

Shanghai – at this time, there is no provision in the bilateral agreement for San Jose – China air service. However, the U.S. government is currently negotiating with the Chinese government to liberalize the air service agreement. Staff continues to monitor the air service negotiations, the economics and industry data with a goal of working with a carrier to provide nonstop service between San Jose and China.

Vietnam – The population base in San Jose and Silicon Valley as well as the growing economy make Vietnam an important target market for new air service. The current bilateral is restrictive and doesn't offer immediate opportunities for nonstop service to San Jose. However, staff is exploring the opportunity for Vietnam bound travelers from San Jose to use Taipei as a convenient connecting point for beyond traffic to Vietnam.

India – The population base in San Jose and Silicon Valley, combined with the technology links between India and San Jose make this market a strong prospect for air service. Further analysis will be conducted.

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