

Reshaping Aviation In The Wake of Covid-19

ITF Roundtable, Session 3: Airports

7 May 2021

Confidential



Contents

1.	Scope of this presentation	3
2.	Outline of the current situation – traffic and finances	5
3.	Policy discussion	9

dan Elliott

 dan.elliott@frontier-economics.com

1.	Scope of this presentation	3
2.	Outline of the current situation – traffic and finances	5
3.	Policy discussion	9

Introduction

Topics I will cover

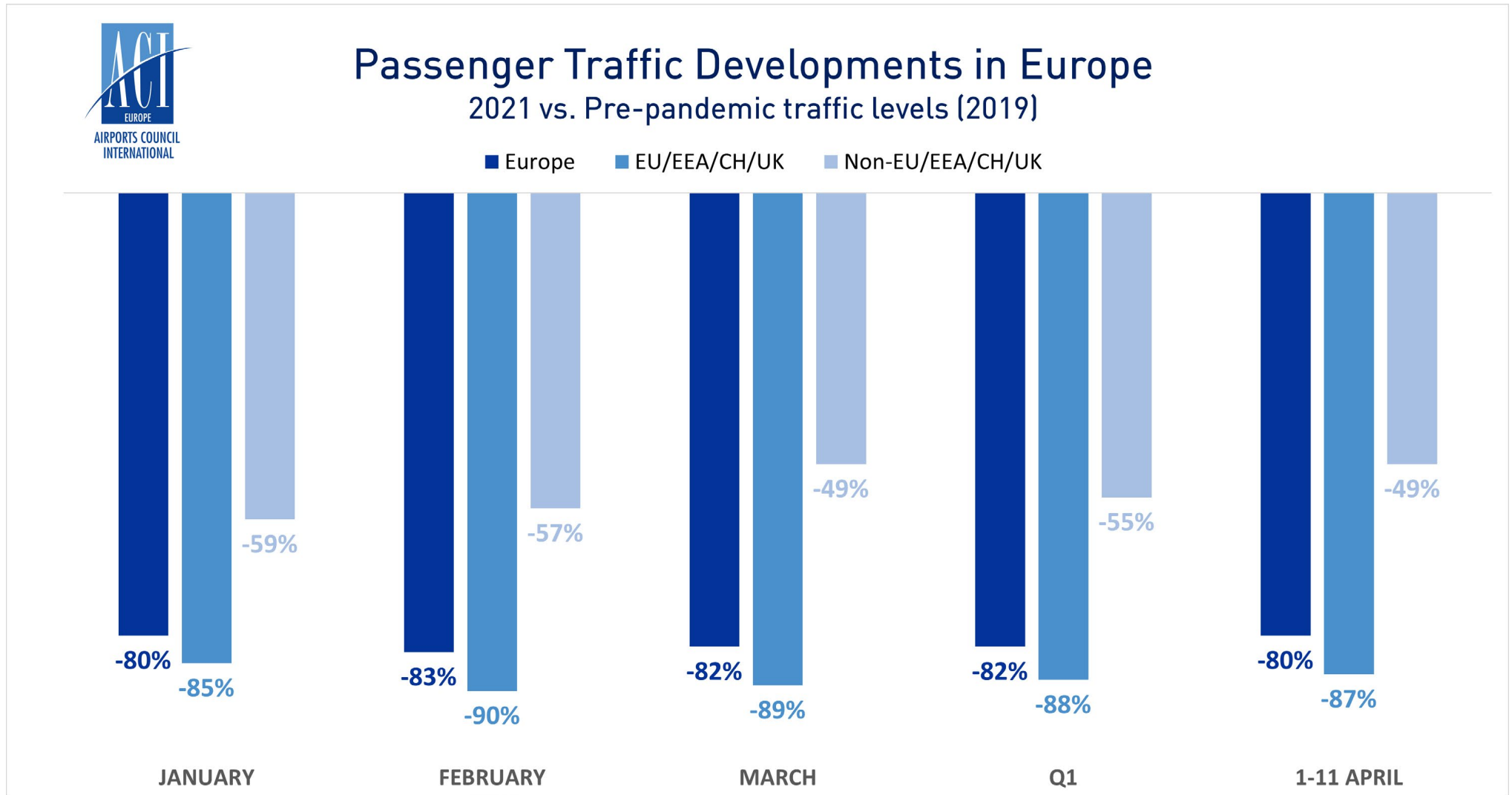
- Airports charges and airport revenue post-pandemic: What are the solutions?
- Regulation of airports: How to design airport regulation for recovery?
- How to safeguard essential connectivity?



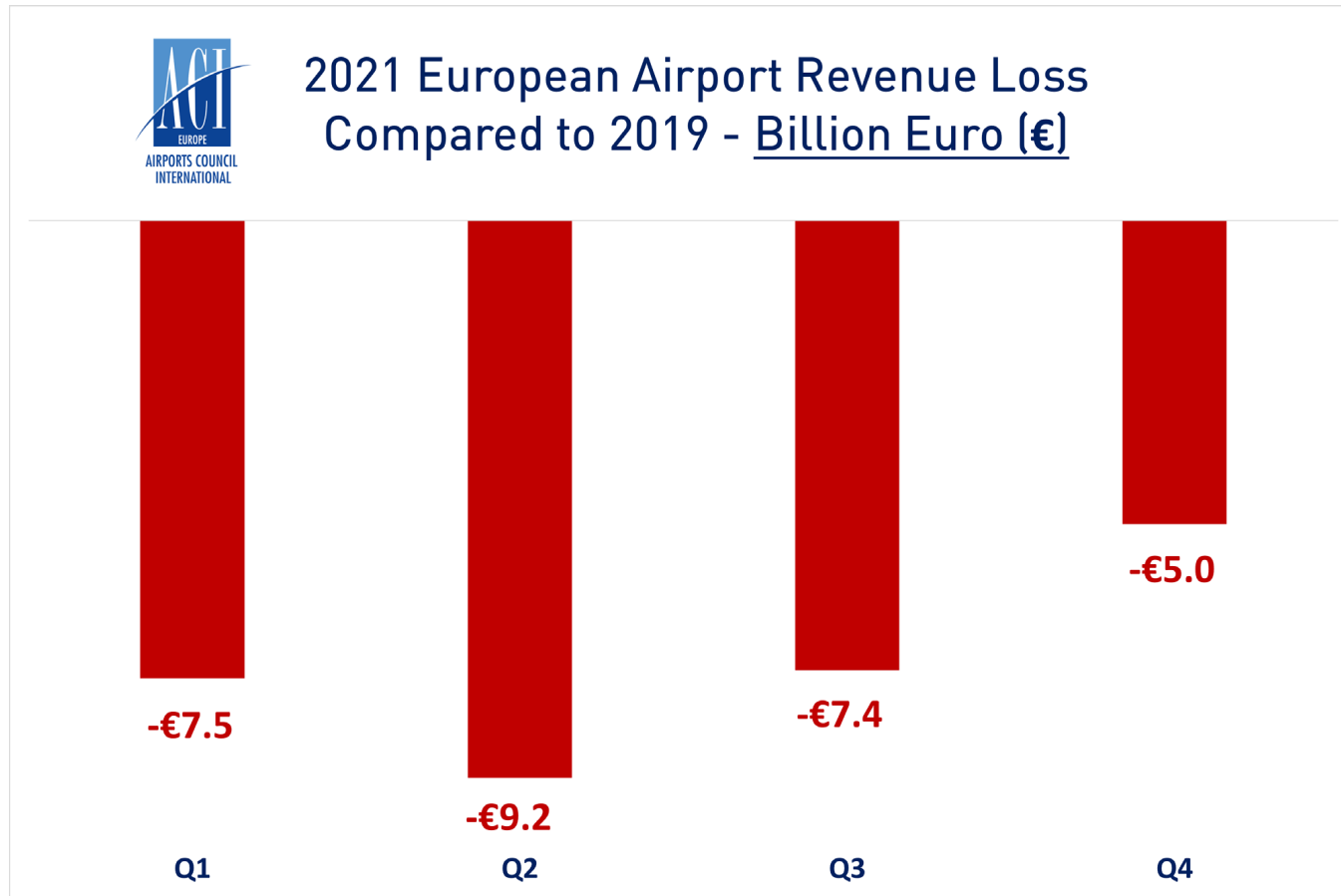
- I will start by summarizing the current position for airports as a consequence of the pandemic
- Will then consider commercial, regulatory and governmental interventions to help with recovery
- Michael Stanton-Geddes from ACI Europe will respond, presenting what steps ACI has seen governments take to date, and identifying gaps

1.	Scope of this presentation	3
2.	Outline of the current situation – traffic and finances	5
3.	Policy discussion	9

Passenger traffic in 2021 remains a fraction of 2019 levels

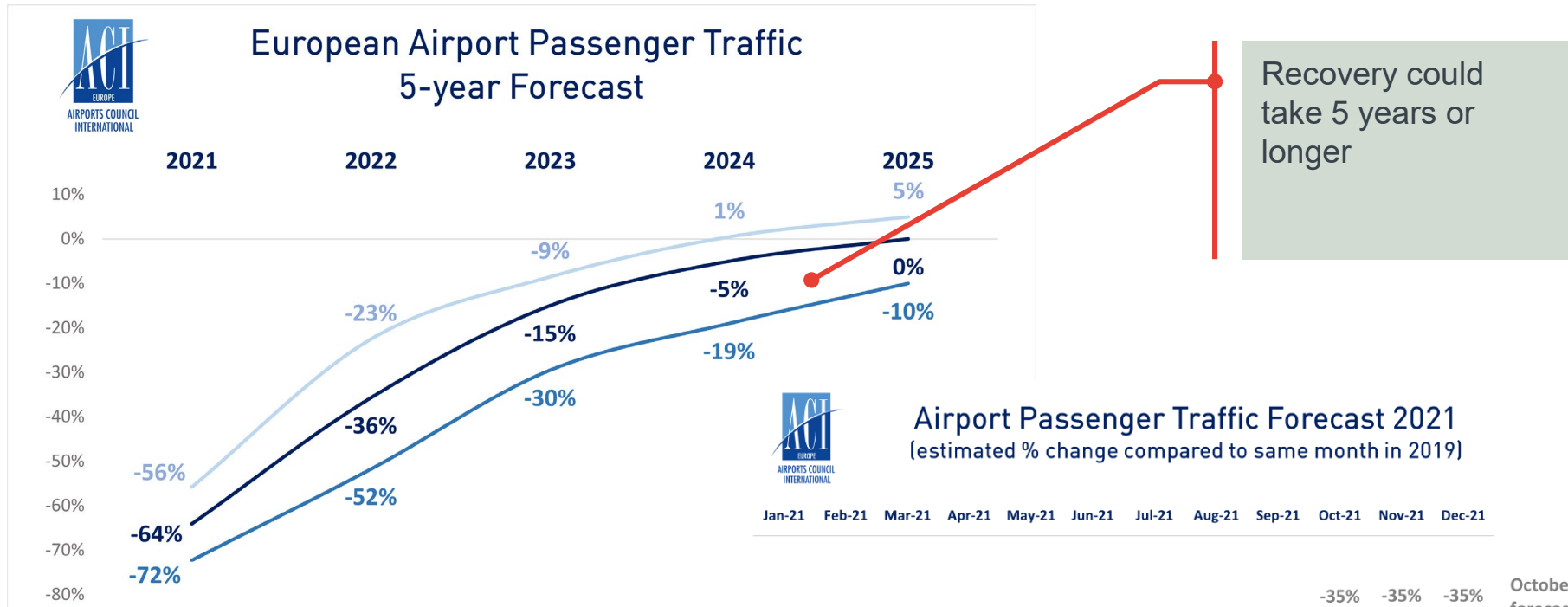


Hit to airport finances has been huge



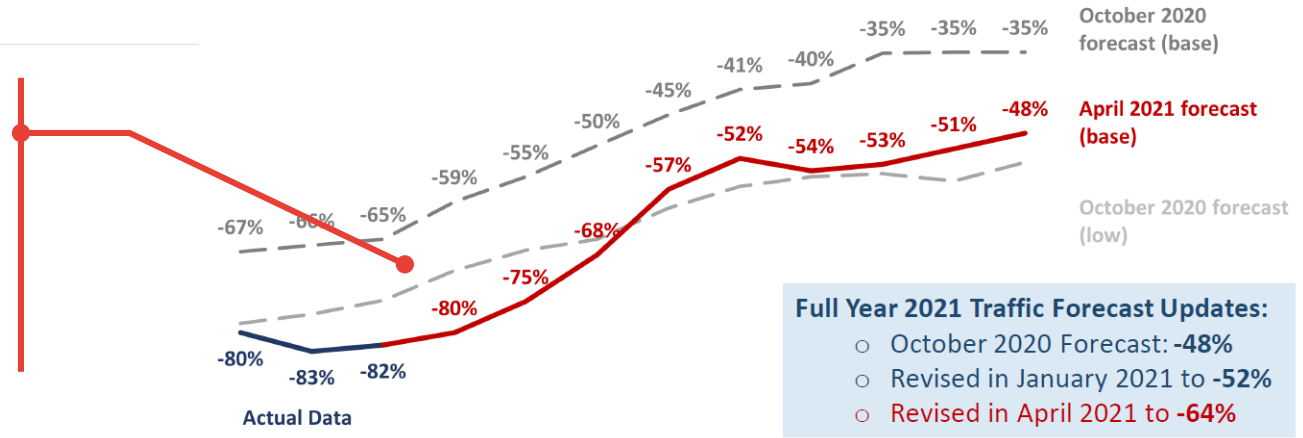
- European Airport Revenue down €30bn in 2020 compared to 2019
- Although traffic recovering, revenue shortfall expected to be similar in 2021
- Increasing competitive pressure means revenues will recover much more slowly than traffic
- Not feasible for airports to reduce costs in line with this level of traffic reduction

Pace of recovery extremely uncertain



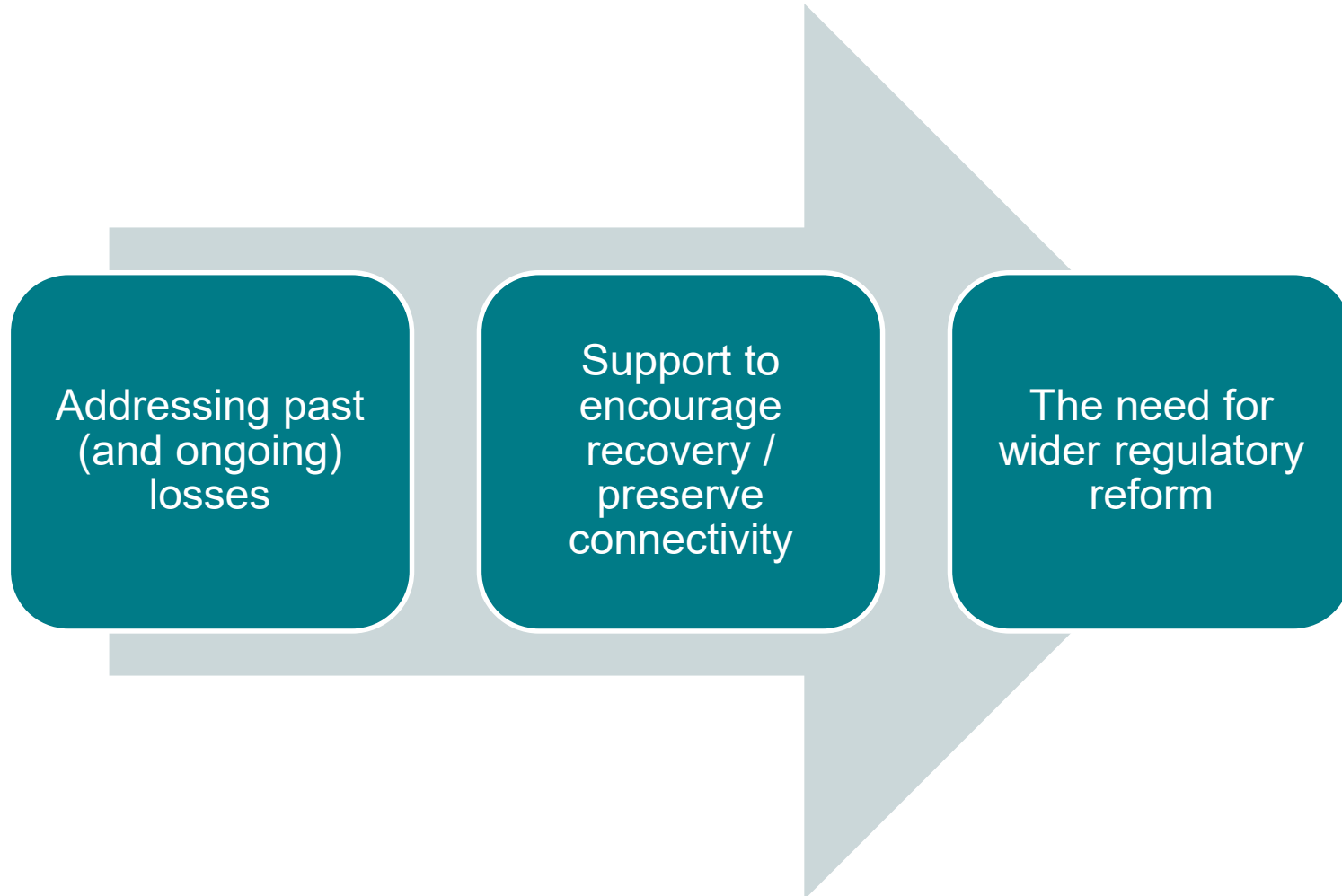
Most forecasts so far have proved over-optimistic
Huge uncertainty:

- Impact of vaccines
- Future precautionary restrictions



1.	Scope of this presentation	3
2.	Outline of the current situation – traffic and finances	5
3.	Policy discussion	9

Key policy questions



Addressing past (and ongoing) losses

Key concerns arising from the damage of 2020 (and ongoing)

- Weakened balance sheets affect ability to invest in future
- Loss of expertise inhibits capacity and capabilities when recovery starts to accelerate
- Funding situation likely to be particularly acute for smaller regional airports, potentially putting connectivity at risk
- Loss of regional airports may exacerbate loss of connectivity

Reasons for retrospective government intervention (i.e. for past losses)

- Loss of traffic overwhelmingly due to travel restrictions (for good reasons), not fall in demand
- Pandemic is the crystallization of a risk that has always been there, but perhaps disregarded
- In future will travel restrictions be an early or late policy intervention when faced with pandemic threats?
- Without recognition there is potential for substantial increase in future airport financing costs

Issues

- Aid should not be selective: airport ownership varies considerably from fully public to fully private, with many in mixed ownership
- Loans can be an effective emergency survival / continuity measure, but do nothing to rebuild balance sheets
- Private equity injections require ability to quantify (to an extent) future risks
- Public equity injection should be used with caution

Support to encourage recovery / preserve connectivity

▪ Average airport costs likely to be higher for many years

- ⑩ Capacity planning could not factor-in pandemic
- ⑩ Neither operating nor capital costs can fully adjust down to lower traffic
- ⑩ But high level of likelihood capacity will be needed, only later than originally expected

Weak commercial airline market will not absorb significant cost increases

- ⑩ Travel restrictions and travel anxiety make for weak demand
- ⑩ In these conditions airlines probably cannot pass on higher costs in higher fares
- ⑩ This will not last forever, but will apply possibly for 1 / 2 years
- ⑩ Airport charges therefore cannot follow costs upwards now for in the near future

▪ Various possible complementary approaches

- ⑩ Continued (time-limited) financial support to loss-making airports to allow charges to be set below average cost for the time-being
 - Allow more pricing flexibility at airports to target support to weaker routes
 - With specific support for “essential” connectivity?
 - New regulatory arrangements (where appropriate) to allow recovery of current losses in future when aviation is thriving again

The need for wider regulatory reform

Most pricing regimes for regulated amount to some form of average price cap

- Some build in risk limitation:
 - prices recalibrated if traffic is above or below predetermined “tramlines”
 - Assumes minor divergence from expectations
 - Passengers (via prices) absorb the “risk” of traffic variation (up or down) in the short- to medium-term

These arrangements not fit for purpose for pandemic-scale losses

- The implied charge increases would be very substantial
- Future level of traffic highly uncertain so revenue risk extremely high
- In short-run implies passing airport losses to airlines (i.e. fares will not adjust)
- Moreover, the experience so far is that even modest increases have been rejected by regulatory authorities, meaning airports do not even have this protection

Regulation often hamstrung by inflexibility

- Simplistic “building block” approaches lead to a rigid in-period “cost recovery” approach incompatible with the flexibility required to address the current situation
- Failure to address this situation will lead to:
 - Under-investment
 - Sharp rise in cost of airport finance

Outline of new regulatory approaches

▪ A new approach to risk in regulatory arrangements

- Explicit limits to the risk borne by investors, incl. how to address future shutdowns
- Acknowledge the impossibility of forecasting demand accurately

▪ More commercial flexibility in airport pricing

- Airports have a strong incentive to encourage traffic growth by sharing commercial risk with airlines
- Demand conditions likely to vary a lot by route and airport
- Requires greater tolerance of “disaggregation” & “demand led pricing”

▪ A new “inter-temporal” flexibility

- “Recoverable” losses need to be deferred by allowing airports to capitalise them in regulated assets (RAB)
- Cost recovery over outputs, not by time-period (consistent with some flexible concession models and project finance agreements)
- Cost deferment window needs to be agreed, in which fares can reasonably absorb increase



Frontier Economics Ltd is a member of the Frontier Economics network, which consists of two separate companies based in Europe (Frontier Economics Ltd) and Australia (Frontier Economics Pty Ltd). Both companies are independently owned, and legal commitments entered into by one company do not impose any obligations on the other company in the network. All views expressed in this document are the views of Frontier Economics Ltd.