

City Council Study Session  
March 8, 2010



NORMAN Y. MINETA  
SAN JOSE  
INTERNATIONAL  
AIRPORT



# Competing in the Marketplace

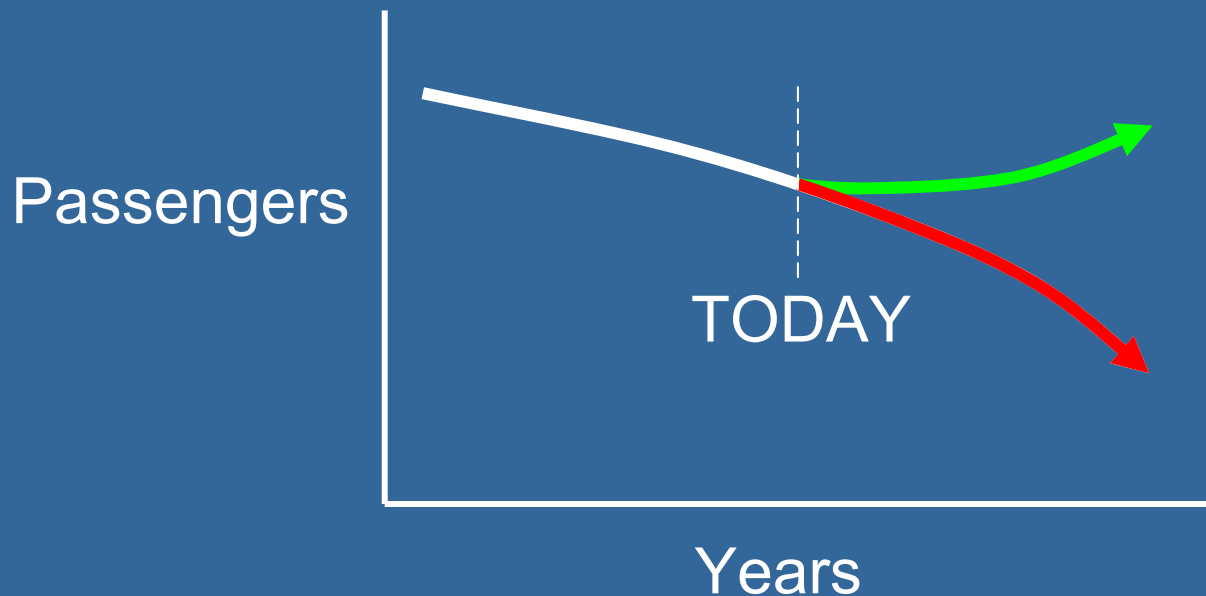
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## City Budget and Policy Issues Affecting Airport Competitiveness



# A Tale of Two Airports

- The Airport is at a critical juncture
- What are the options for the **future**?



# The Airport is an Economic Engine

- Revenues come from landing fees, rents, concession fees and other user fees
- No local taxes are used to build and support the Airport
- Nearly 5,000 non-city employees work at the Airport
- Approximately \$4 billion a year in spending generated by Airport activity



# Competing in the Marketplace

The Airport faces direct competition in the marketplace

- The Airport must compete for flights and passengers
- Airlines have options/alternatives where to profitably place their assets (planes)
- To be competitive, SJC must offer a superior product at a competitive price
- The Airport is the only City service that faces direct market competition

# Airport as a Economic Generator

## Airport cost competitiveness

- ✓ CPE
- ✓ Other policies impacting airline profitability

## Increased # of flights/passengers

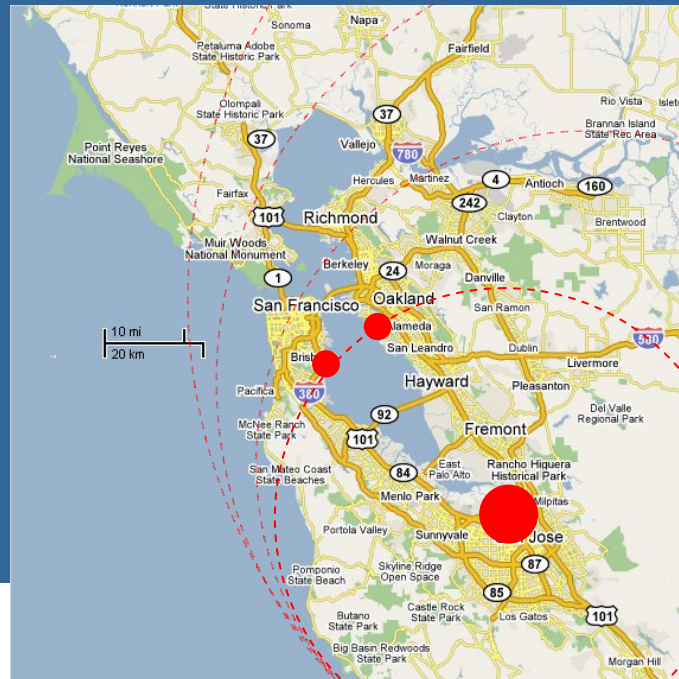
## Increased economic impact to the City

- ✓ Jobs
- ✓ Spending
- ✓ Fiscal rating



# Who are SJC's Competitors?

- ✓ San Francisco (SFO)
- ✓ Oakland (OAK)
- ✓ Every commercial airport in the world



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# Key National Air Industry Trends and the Airline Industry Worldview

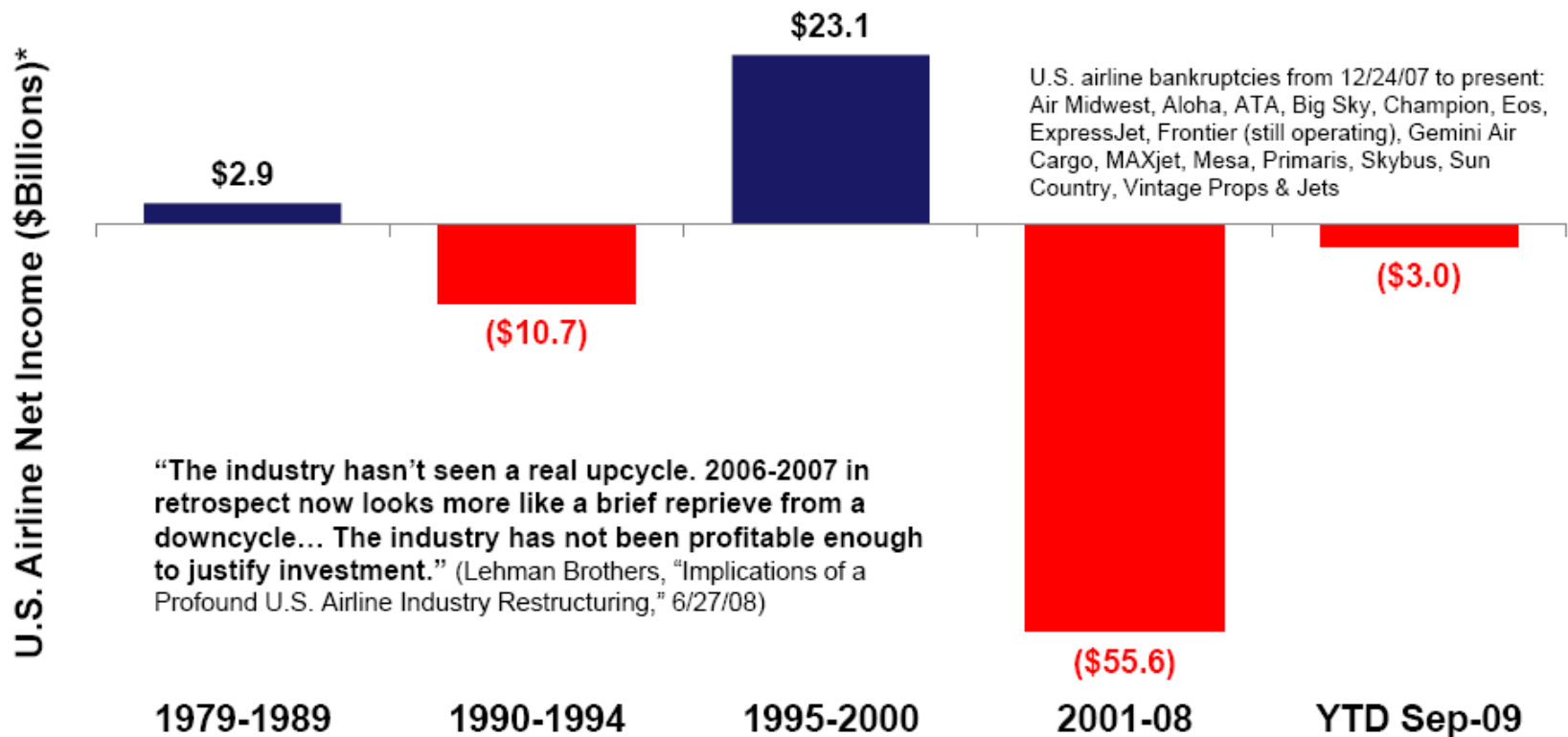
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# For U.S. Airlines, Losses / Volatility Have Been the Norm

## Losses Continue to Mount in 2009

“While at the start of the year we were projecting a modest net profit for the industry despite the worst global economic downturn since World War II, our forecast has been stymied by the impact of the H1N1 influenza, creeping energy prices, and a revenue environment that is showing no signs of improvement.” – Michael Linenberg, Merrill Lynch, “Mounting challenges likely mean industry net loss for '09” (6/15/09)

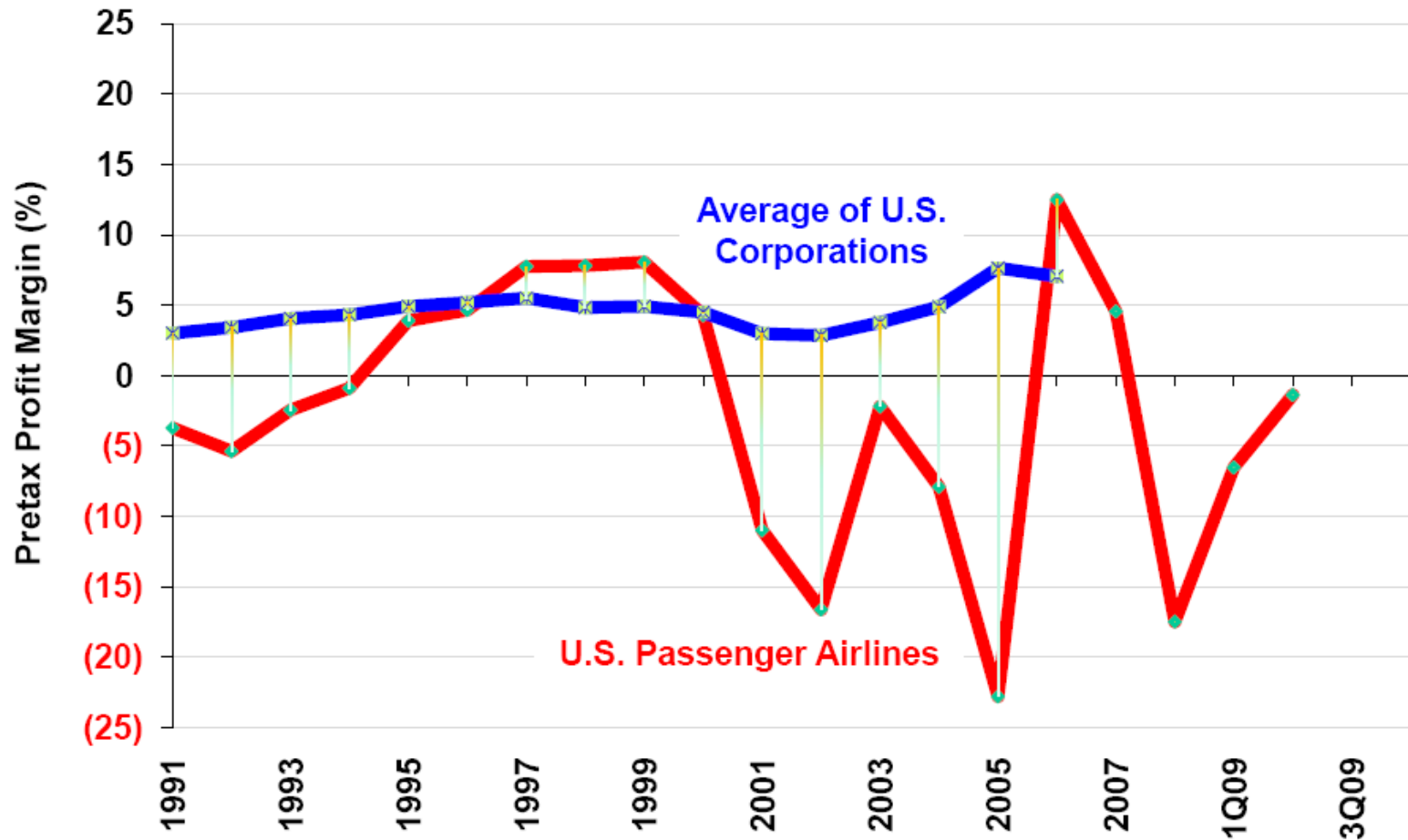


\* U.S. passenger and cargo airlines: DOT Form 41 P-12

Sources: Bureau of Transportation Statistics and Data Base Products

# Airline Industry Profitability Elusive

Pretax Profit Margin Highly Cyclical and Well Below U.S. Corporate Average



Sources: (1) IRS Statistics of Income ([Historical Table 13](#)) – “Net income (less deficit)” divided by “Total receipts”; (2) ATA Cost Index

# DOT Data: Average Domestic Ticket Prices at 1998 Levels

U.S. CPI Rose 40.8 Percent from 3Q 1995 to 3Q 2009,  
Leaving Prices \$98.41 “Short.”

“Thursday, January 28, 2010 – Average domestic air fares in the third quarter of 2009 fell to their lowest July-to-September level since 2005, dropping 14.4 percent from the third quarter of 2008 in the largest year-to-year decline on record, BTS reported today.”



Note: BTS reports average fares based on domestic itinerary fares (round-trip or one-way for which no return is purchased). [Averages do not include frequent-flyer or “zero fares.”] Fares are based on the total ticket value, which consists of the price charged by the airlines plus any additional taxes and fees levied by an outside entity at the time of purchase.

# Just Raise Fares?

- Raising airfares isn't like raising the price of milk... Consumers have almost perfect information... —the Internet can hunt the cheapest fare worldwide in seconds. If one carrier has some empty seats to fill, it will have to cut the price because getting something for that seat is better than flying it empty.

Scott McCartney, —As Airlines Cut Back, Who Gets Grounded?  
*Wall Street Journal*, (6/5/08)

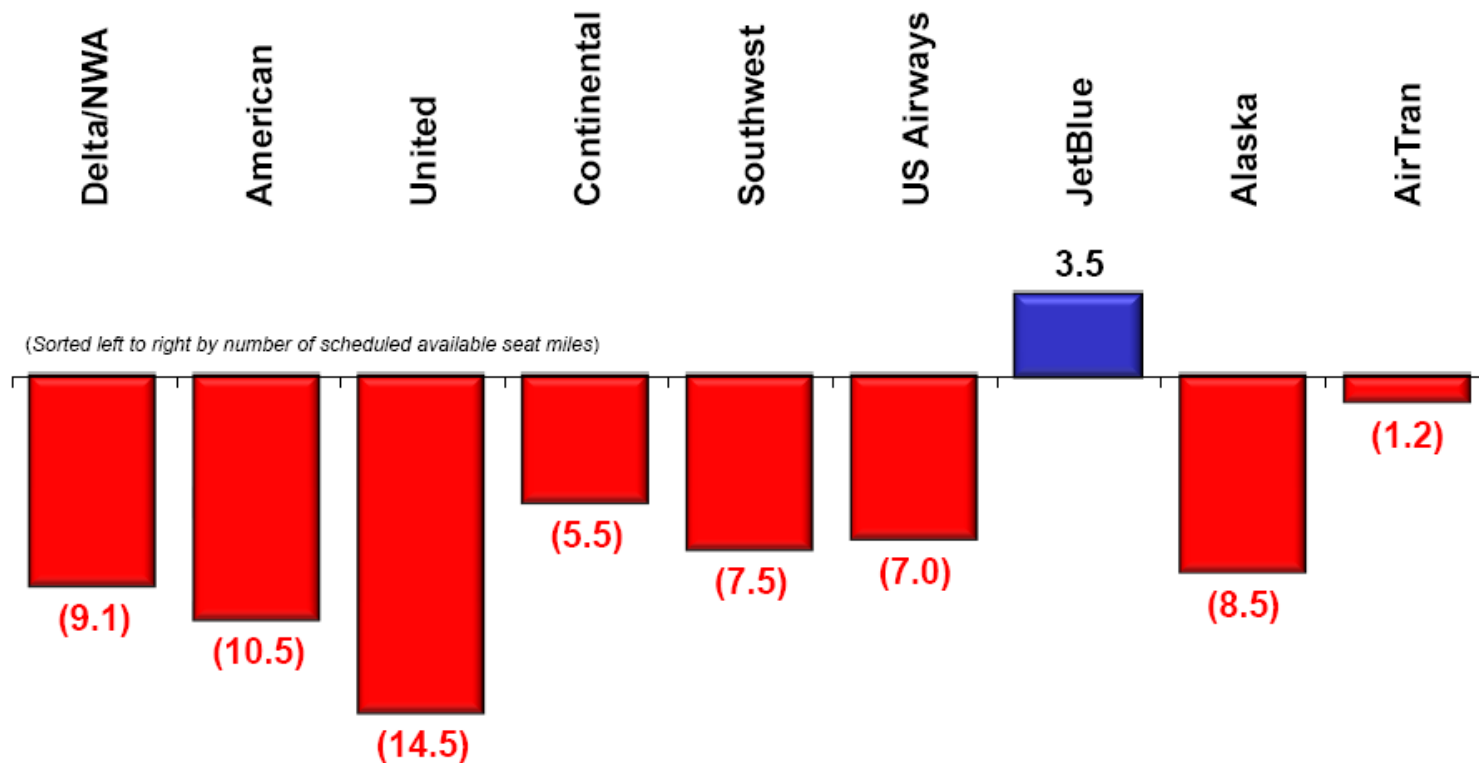
- It's very difficult for airlines to simply raise prices to levels that cover their higher fuel costs. Raising prices chokes demand: If tickets get too expensive, business travelers make alternate plans, pick cheaper airlines or buy discounted tickets further in advance. For vacationers, if prices get too high, they don't buy or they switch to cheaper destinations.

Scott McCartney, —What to Expect as Airlines Cope With Soaring Fuel Costs, *Wall Street Journal* (5/22/08)

# What a Difference Two Years Have Made in Airline Capacity

Recession, Regulation and Fuel-Price Volatility Have Culminated in Deep Cuts

% Change in Scheduled-Service ASMs: 1Q 2010 vs. 1Q 2008



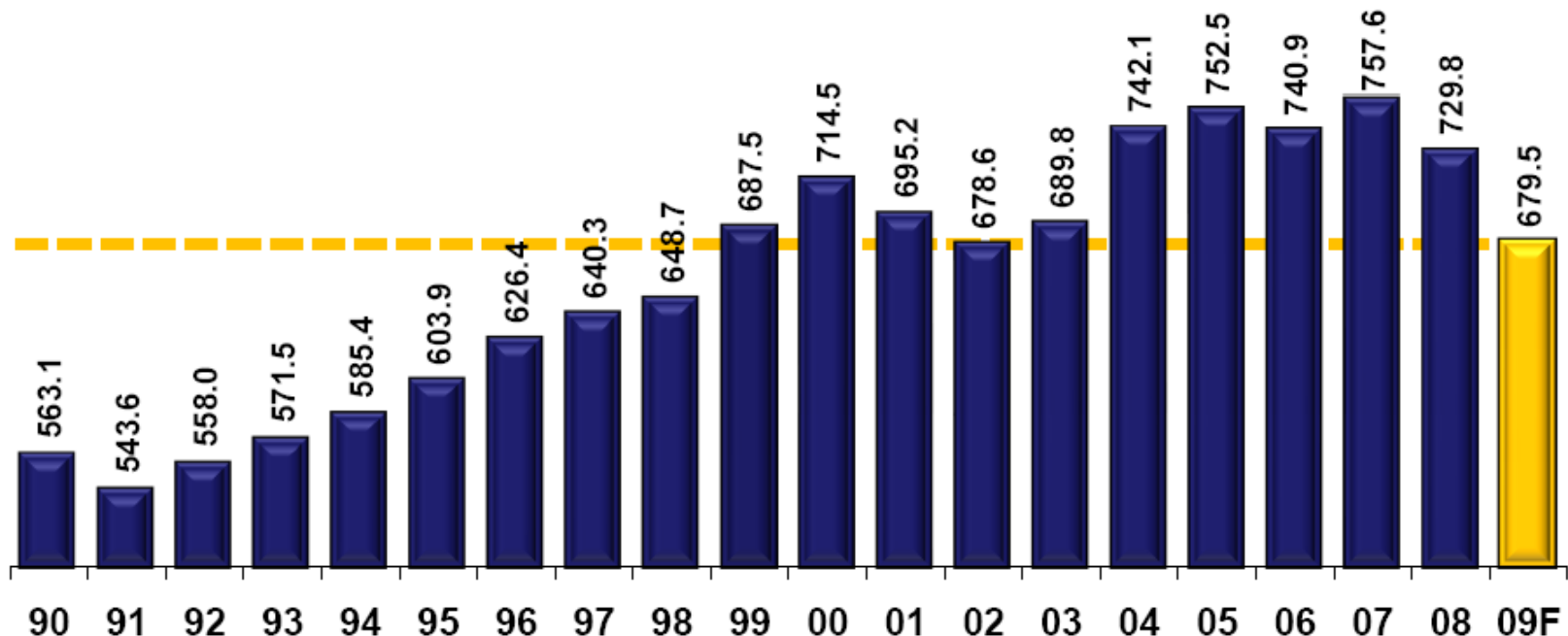
\* An available seat mile (ASM) is one seat flown one mile and is the standard unit of capacity in the passenger airline sector  
Source: Innovata via APGDat (Feb. 22, 2010)

# Domestic Seating Capacity Fell Below 1999 Level

Available Seat Miles (in Billions) Operated in Domestic U.S. Scheduled Service

“The cuts to domestic capacity in 2009 are likely to bring the industry back to levels not seen since the late 1990s. Furthermore, we think an economic recovery is not likely to result in meaningful capacity additions given other forces at play. Notably permanently higher energy costs, higher capital costs, higher environmental costs and higher regulatory costs are factors forcing managements to keep fleet growth flat to modest for at least the next several years. Until the current airline fleets start producing positive returns on the underlying invested capital, we don’t expect to see much growth in domestic fleets anytime soon.”

Michael Linenberg, Bank of America/Merrill Lynch (Oct. 9, 2009)



# Economy, Fuel, Taxes, Regulation Continue Toll on Jobs

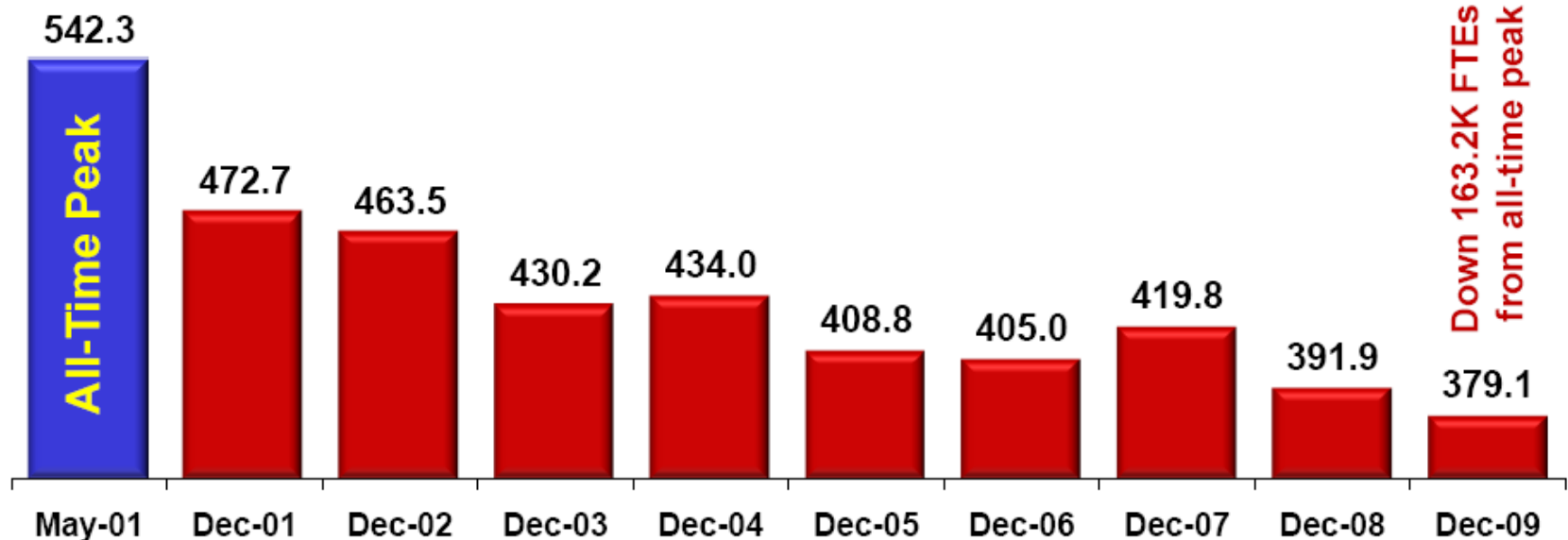
## Passenger Airline FTEs Down 30% from May 2001 All-Time Peak

“Why are companies still laying people off if the economy’s looking better? A closer look at the airline industry might help answer that question. While carriers say they see glimmers of evidence that the plunge in passenger demand that began a year ago is bottoming out, they aren’t seeing many signs that travelers are coming back or are willing to pay more for tickets. So the airlines are continuing to trim jobs, drop money-losing routes and take seats out of the air. The shrinking began in earnest in 2008, when oil prices were surging, but the recession gave them new incentives to keep it up late last year and into 2009. And now fuel prices are rising again, giving more cause for alarm. The Department of Transportation said U.S. airline employment in August fell 5.5% from the year-ago month, for the 14th consecutive monthly decline. The August airline job number, 384,000 workers, was the lowest since 1993, the government said.”

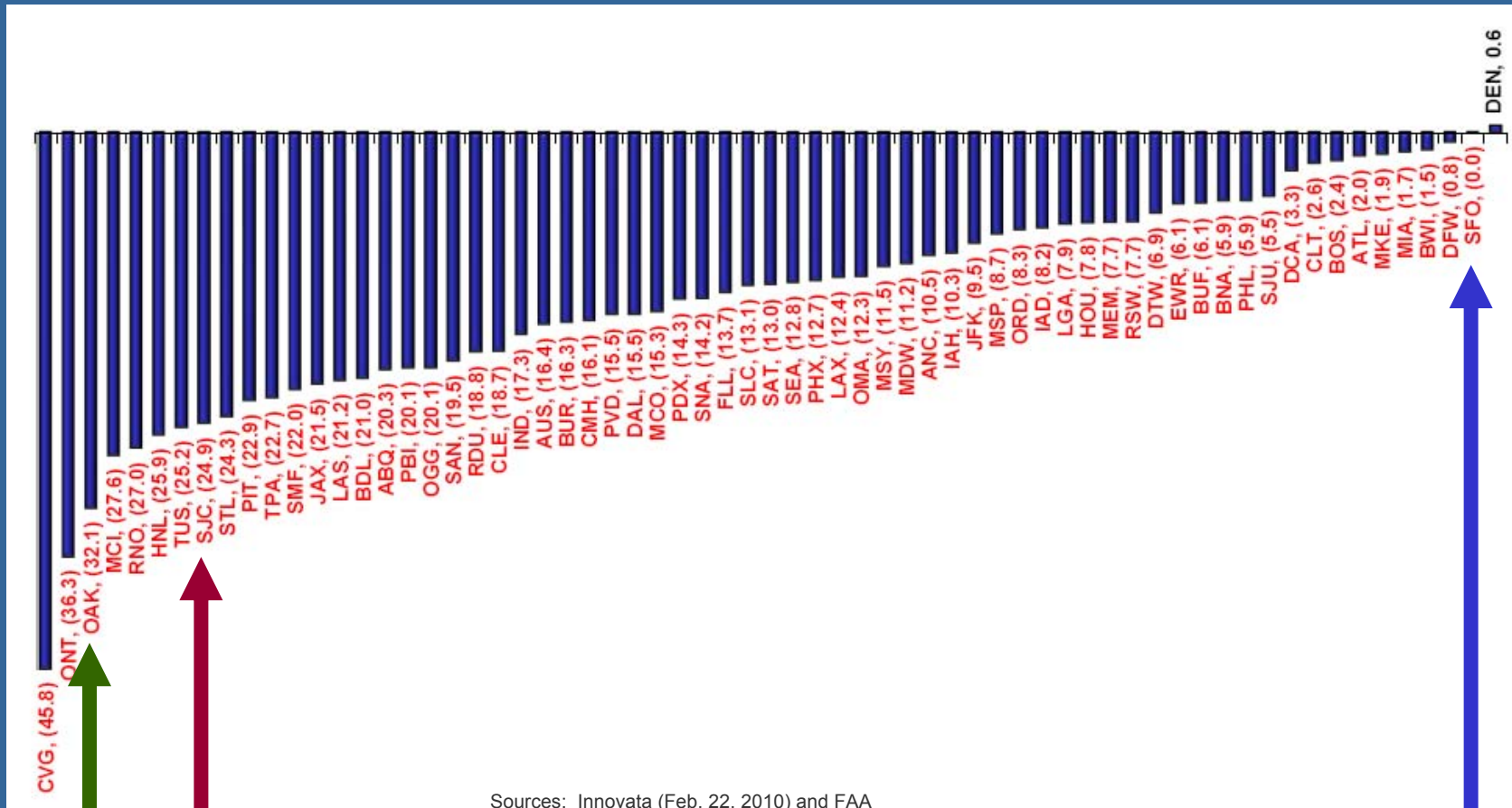
Susan Carey, “Airlines Illustrate Why Layoffs Continue,” *Wall Street Journal* (Nov. 6, 2009)

### Full-Time Equivalent Employees (000) at U.S. Passenger Airlines

Source: Bureau of Transportation Statistics ([http://www.bts.gov/programs/airline\\_information/number\\_of\\_employees/](http://www.bts.gov/programs/airline_information/number_of_employees/))



# % Change in Scheduled-Service Departures: 1Q 2010 vs. 1Q 2008



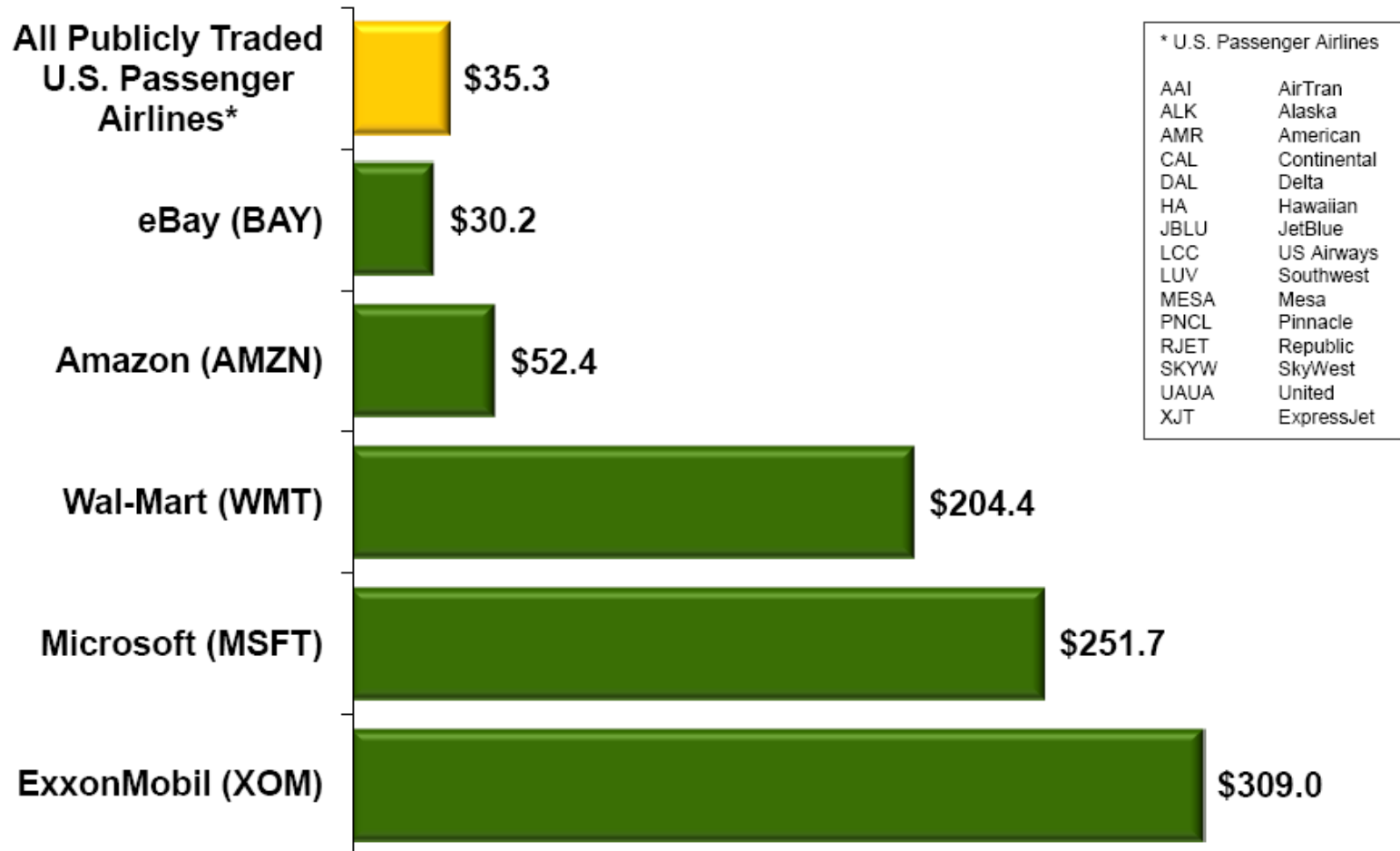
**OAK**  
-32.1%

**SJC**  
-24.9%

**SFO**  
0%

# U.S. Passenger Airlines\* Market Value in Context

Market Capitalization (Billion USD) as of Feb. 22, 2010 @ 12:40 PM



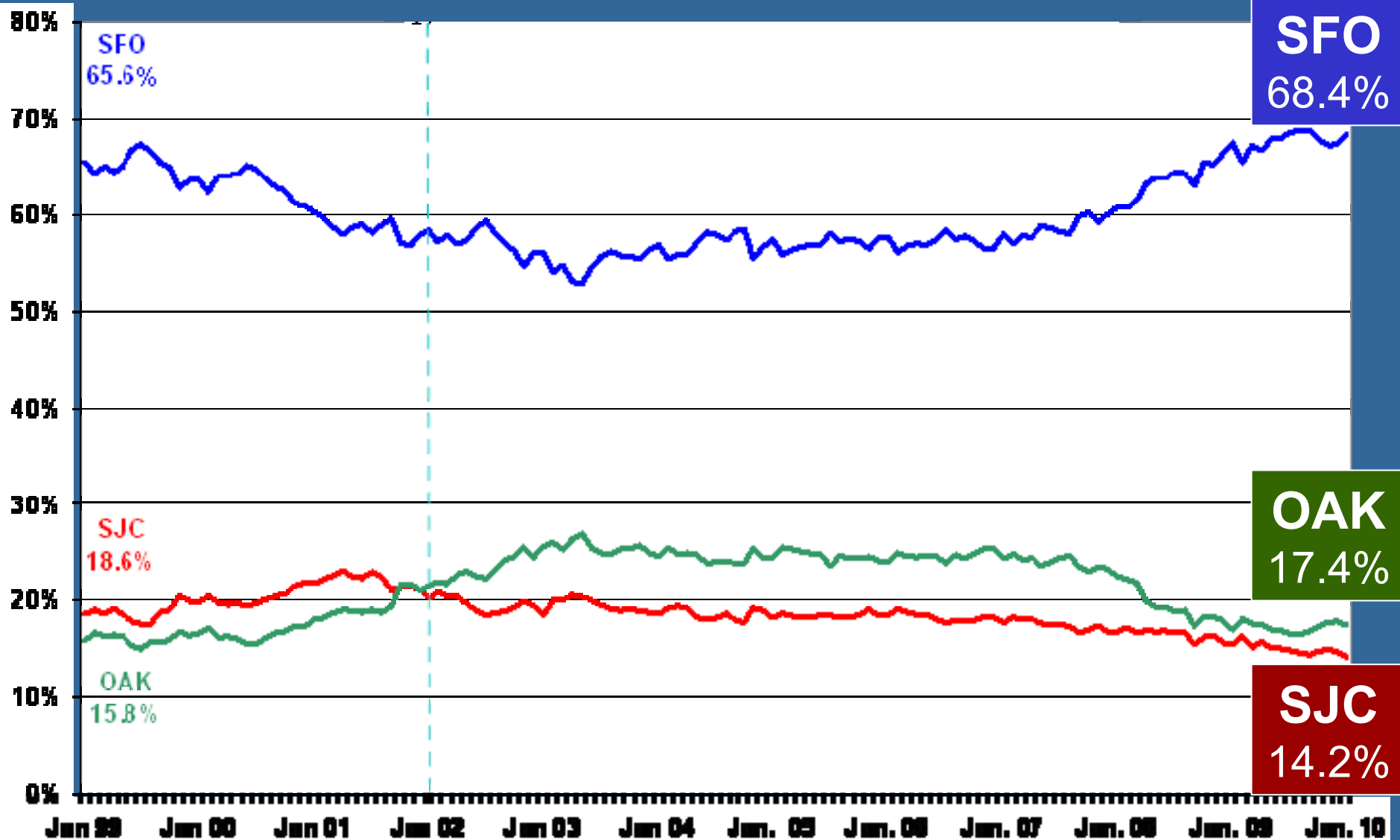
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# Bay Area Air Service Trends

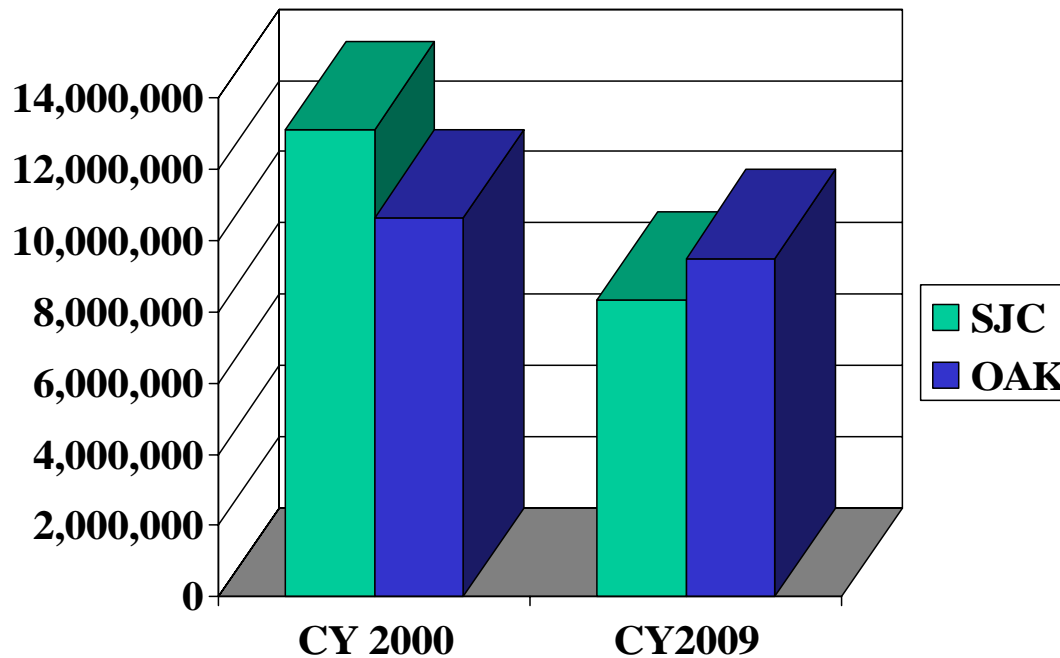
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# Bay Area Passenger Monthly Market Share History



# Change in SJC-OAK Market Share CY 2000-2009



## Between CY 2000-2009:

- SFO lost 8.8% of its passengers
- OAK lost 10.5% of its passengers
- SJC lost 36.5% of its passengers
- OAK surpassed SJC in passengers in CY 2002

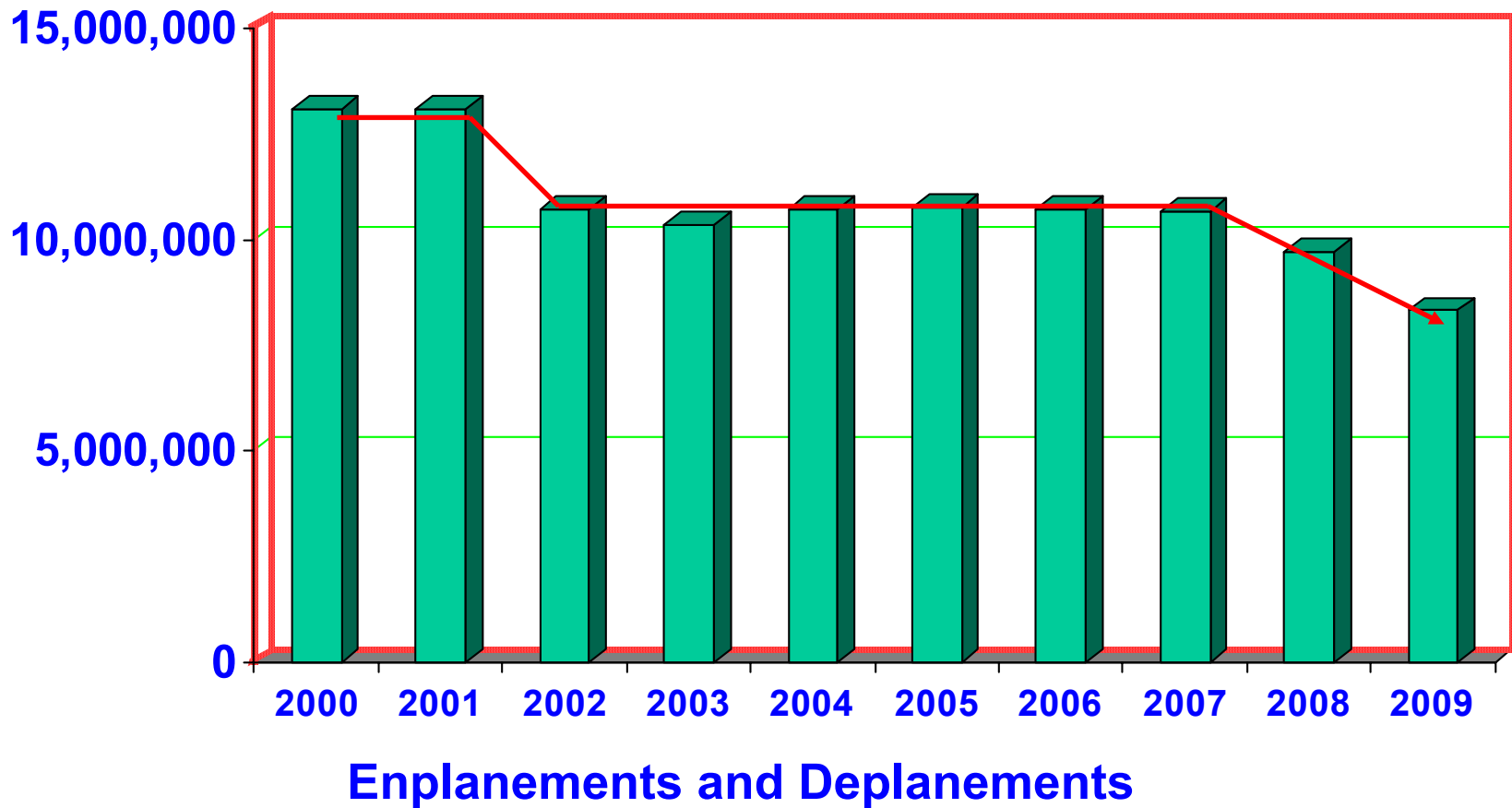
# Key Factors Driving Bay Area Air Service Trends

- Airlines are reducing capacity in seats and flights to achieve profitability
- “The Herding Mentality–Virgin Effect” at SFO = 592 flights (80,200 seats) a week at SFO that *did not exist* in 2007



# The Air Carriers are Talking to Us

– What are they saying?



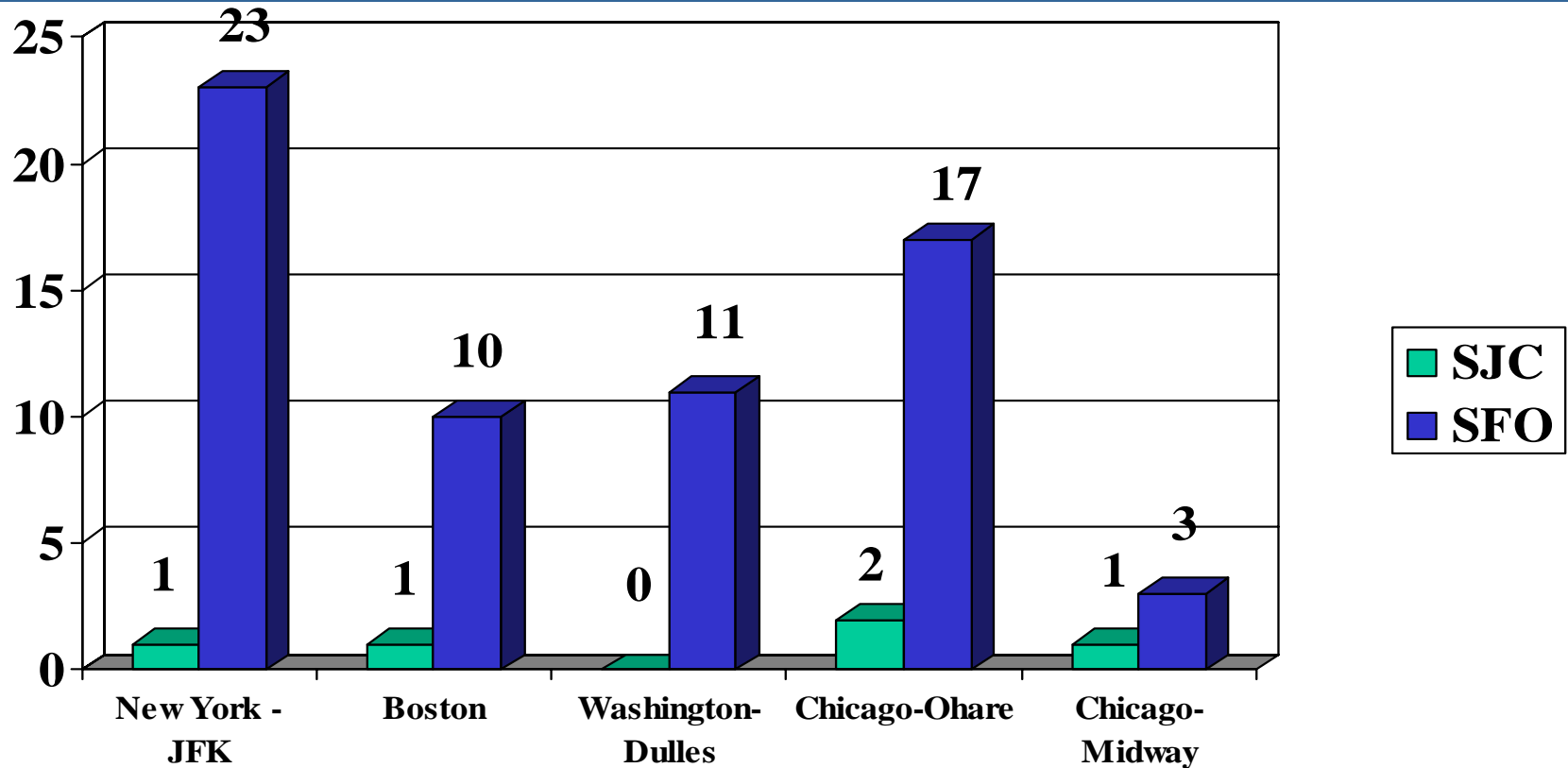
# San José's Declining Position in the Bay Area and National Marketplace

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- 8.2 million passengers a year projected for 2010 – down from 13.9 million in 2001 (-41%)
- 39th busiest airport in the nation – for the nation's 10th largest city
- 125 commercial flights a day – down from 190 flights a day in 2007 (-33%)
- Declining share of Bay Area air service market

# Impact of Bay Area Market Trends

## SJC vs. SFO Departures to Four Key Cities



**SFO has 64 daily flights to the four cities**  
**SJC has 5**

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# Cost Per Enplaned Passenger (CPE)

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# CPE: Cost per Enplaned Passenger

CPE is a RATIO, not a fee:

Costs divided by number of passengers

Operations and  
Maintenance  
Expenses

+

Debt  
Service

=

**CPE**

Enplaned Passengers

# As Costs Increase, CPE Increases



# As Passengers Decrease, CPE Increases

Costs

CPE

↓  
Passengers



=

# New Debt Service is a Major New Fixed Cost as Passenger Traffic Falls

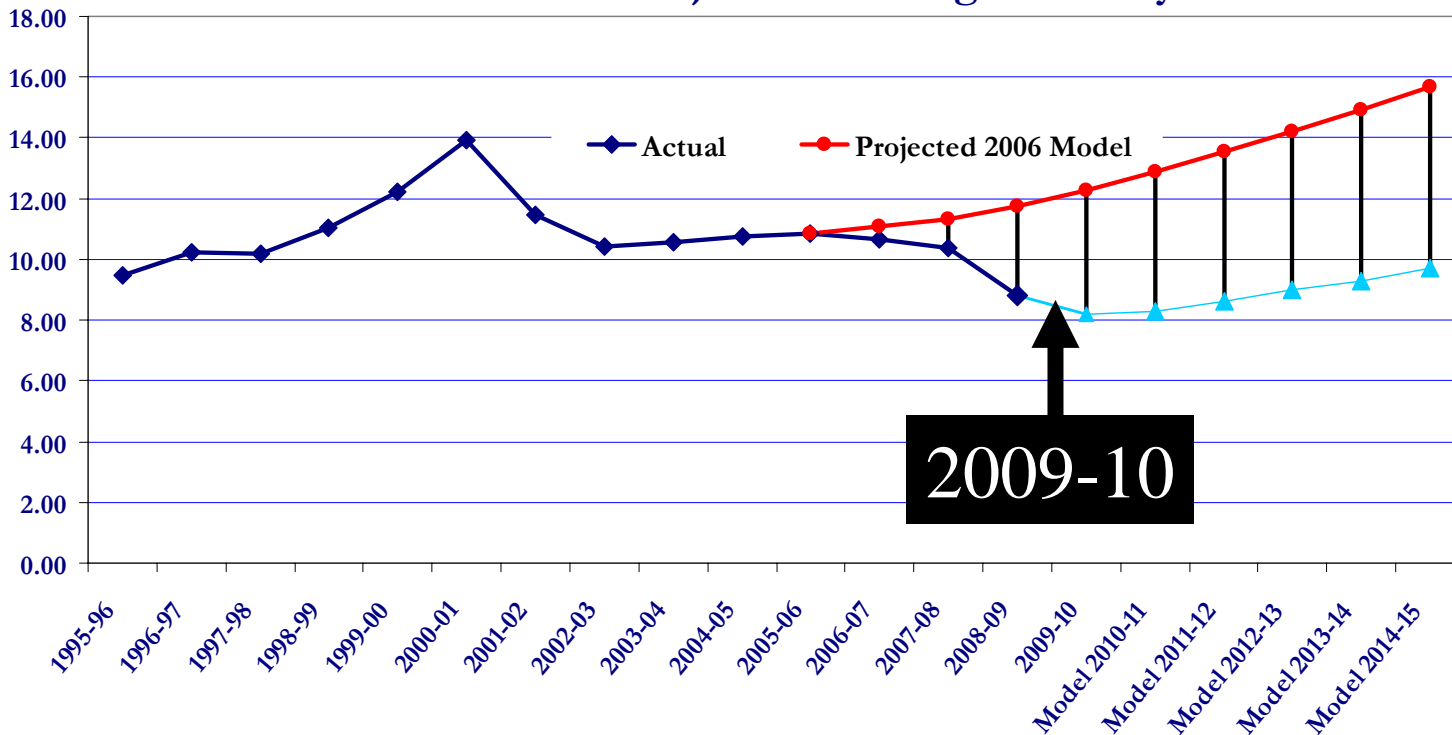
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*CPE Will Increase Without More Cost Cuts or More Passengers*



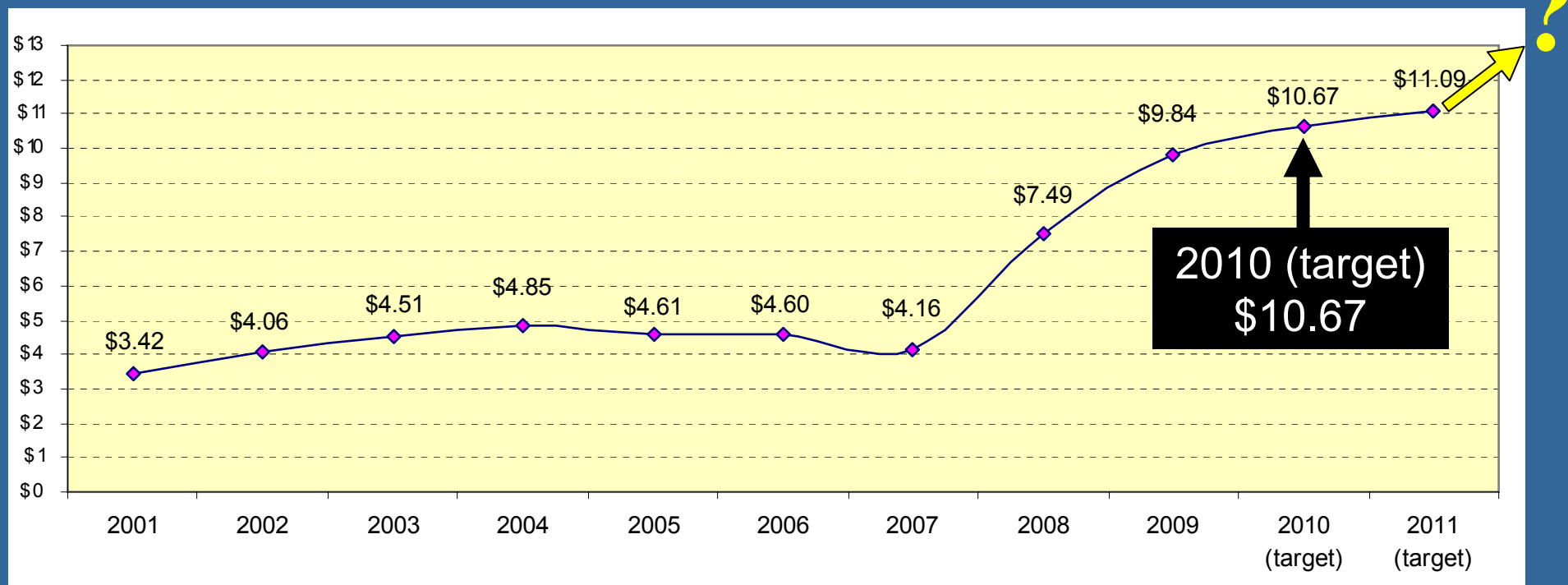
# “The” Problem – Declining Passenger Activity

Mineta San Jose International Airport  
Actual and Projected Passenger Activity

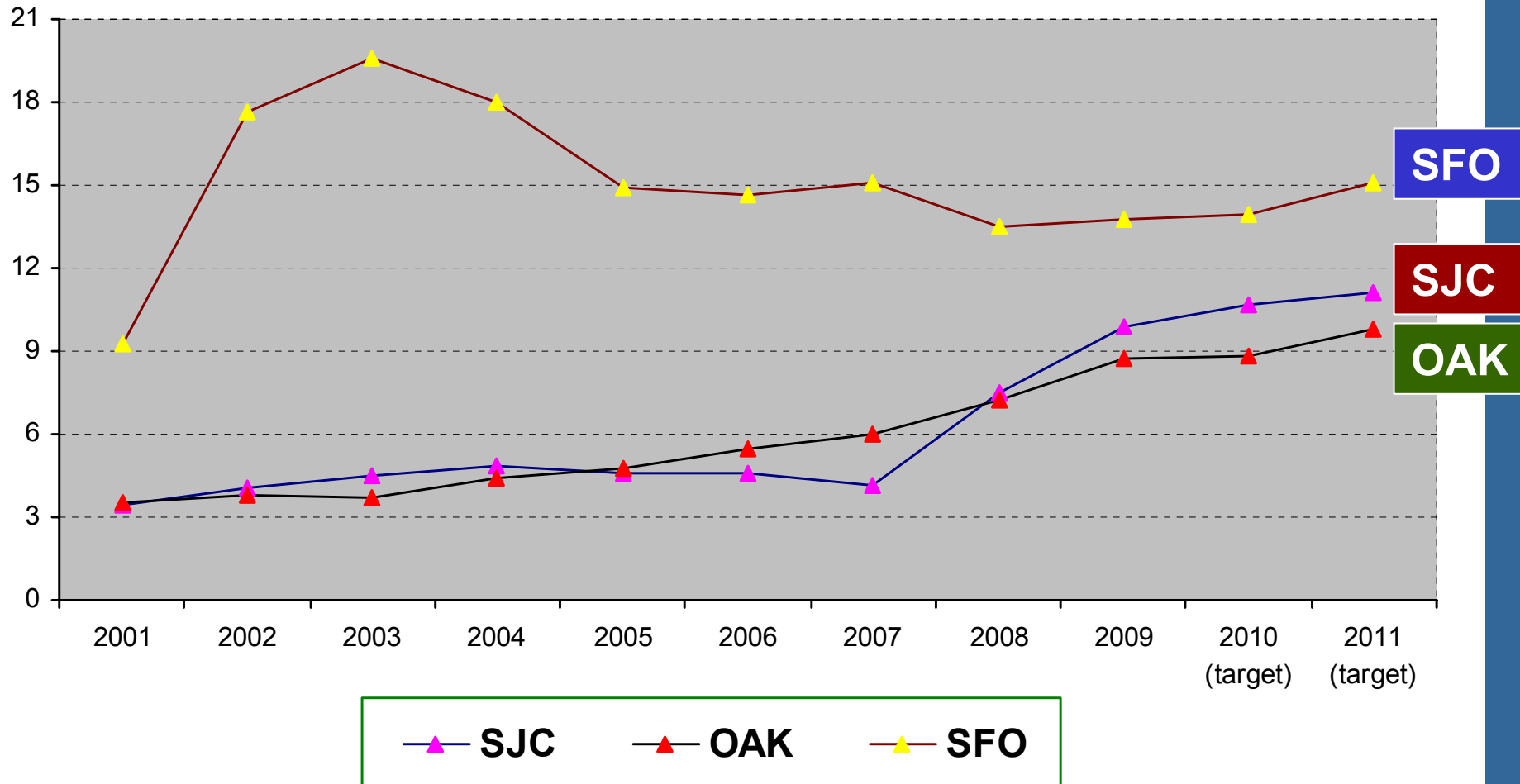


6 million  
Passengers  
= \$90 Million

# SJC CPE 2001-2011(targeted)



# Airline Cost per Enplaned Passenger (CPE)



# Reducing CPE Costs

- SJC's CPE needs to remain “considerably below” SFO to avoid further reductions in air service
- To achieve a competitive CPE, SJC must make substantial additional cost cuts

**Each dollar of CPE reduction  
requires approximately \$4 million  
in SJC budget cuts or new revenue.**

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# Budget and Policy Options for Effectively Competing in the Marketplace

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# Addressing Budget and Policy Challenges

- Need a City commitment to build and operate a competitive world class airport
- The Airport has taken all the significant steps it can to reduce its operating costs:
  - Reduced staffing
  - Increased revenue through new food, beverage, retail, advertising and rental car concessions
  - Considered raising parking rates
- The Airport has aggressively pursued new air service

# Budget and Policy Challenges to Successfully Compete in the Marketplace

- Some policies add costs to the CPE
- Some policies add to the airlines costs to do business in San José
- Some policies are not easily quantifiable but add to the challenges, complexities and costs to the Airport's competitiveness

# Options to Lower the CPE

## Potential Savings

### Contract out certain services

- SJC custodial services \$ 3.0 million/ year
- Aircraft fire protection services \$ 2.6 million/ year
- Police services \$ 6.4 million/ year

### Defer public art funding for TAIP

- TAIP public art funding allocated FY10/11 to FY 12/14 \$ 3.0 million/ FY

# Options to Lower the CPE

## Potential Savings

- Reduce Fire Department staffing \$ 1.6 million/year
- Reduce non-public safety City overhead to Airport \$ 3.4 million /year
- Reduce police and fire overhead to Airport \$ 1.7 - \$ 3.5 million/year
- Restructure or reduce VTA Flyer Service \$ 600,000/year

# Options to Impact Airline Operating Costs

## – Living Wage/Prevailing Wage

- Reduce living wage rates at SJC
  - SJC rate is 22% higher than SFO and 13% higher than OAK
  - Higher rate creates a competitive disadvantage for SJC
- Change living wage enforcement from proactive to complaint-based
  - SFO and OAK both have complaint-based enforcement
  - Potential savings: \$158,500 a year

# Options to Impact Airline Operating Costs

## – Living Wage/Prevailing Wage

- Allow a cure period of 30 days for noticed violations
- Extend the existing exemption for airlines
- Waive prevailing wage rate requirement on third party tenant construction at the Airport

# Review Other City Policies Impacting SJC Competitiveness

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- Authorize a full analysis of the impacts of altering or eliminating the curfew at SJC
  - Would likely postpone and change the NTAIP
- Protect the Airport from the adverse impacts of both downtown obstructions and high speed rail by preserving clear departure paths over downtown for long-haul flights

# Prudent Use of TAIP Program Savings/Excess Bond Funds

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- \$78.5 million projected to be left over in excess restricted bond funds
- Consider using excess bond funding to partially pay down SJC debt service and keep the CPE competitive (not recommended)
- If not used for debt service, fund Terminal B public parking garage at current estimated cost of \$55 million

# Other Cost and Efficiency City Policies/ Practices Impacting SJC Competitiveness

- ✓ Cost of the Acoustical Treatment Program
- ✓ Master Plan implementation requirements
- ✓ Environmental initiatives
- ✓ Multiple cost accounting systems
- ✓ Taxi administration

# Important to Remember!

- The Airport has taken actions to balance its budget through FY 10/11 but not in FY 11/12 and beyond
- The competitiveness issues facing the Airport will begin in FY 11/12
- Goal is to take the time now to identify, study and prepare to implement solutions to address the competitiveness issues that will impact the Airport in 2012 and beyond

# Tale of Two Airports

## The bottom line



*“Keeping costs low doesn’t ensure success,  
but not controlling costs will certainly ensure failure”*

*– Bill Sherry, Director of Aviation, SJC*

# Discussion Questions

1. What questions does Council have about the problem?
2. What reactions does Council have to the options available to solve the problem?



# Potential Next Steps

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1. Return to Council with a recommended plan to keep the airport competitive
  - Include: How to balance the 2010-11 Airport budget
  - Include: Recommended package of options to affect 2012 and beyond
  - Include: Timeline for Council decision-making and staff implementation
2. Develop this plan and conduct any further analysis within existing resources (staff and financial)