



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: John Aitken

SUBJECT: AIRPORT COST PER
ENPLANED PASSENGER
TARGET

DATE: June 2, 2020

Approved

Date: 6/2/2020

RECOMMENDATION

Approve a change to City Council direction concerning the Airport's Cost per Enplaned Passenger (CPE) target by: (a) rescinding the \$11 to \$12 CPE target established in 2010; and (b) directing Airport staff to use its best efforts to maintain a CPE that is competitive with the other airports in the region.

BACKGROUND

On May 25, 2010, City Council approved an Airport Competitiveness Strategic Plan that included a target for Cost per Enplaned Passenger (CPE) between \$11 and \$12.

The CPE is an industry standard metric that gives some indication of an airline's costs to operate at a particular airport. The CPE is not a rate on its own, but is an average ratio calculated by summing the Airline Rates & Charges revenue items (Landing Fees and Terminal Rentals) and dividing by enplaned passengers. As enplanements increase, CPE will decrease; or as costs decrease, CPE will decrease. As enplanements decrease, CPE will increase; or as costs increase, CPE will increase.

The Strategic Principles for Airport Competitiveness were established in 2010 to provide a framework for maintaining Airport safety, security, customer experience and core functionality, while exploring cost-effective service delivery methods and aggressively seeking air service growth. The 2008 recession had severe and continuing impacts on travel demand and air service in both San Jose and across the nation. In 2010, it was critical for the City and Airport to address cost challenges, budget and policy issues that constrained the Airport's competitive position. Solutions that developed ongoing cost savings and reduced the Landing Fees and Terminal

Rental rates for airlines were prioritized in the Airport Competitiveness Strategic Plan and contributed to maintaining the targeted CPE.

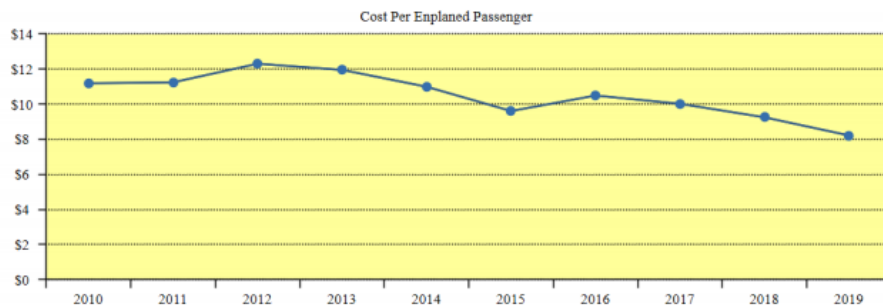
By 2012-2013 as the economy started to recover, SJC started a year-over-year growth pattern that resulted in a new all-time high passenger number of 14.3 million in December 2018 and continued to grow. Staff did not ever return to Council to eliminate the \$11 to \$12 CPE target, as maintaining a CPE below \$12 was occurring organically by:

1. Maintaining operating expenses (including staffing) at conservative levels, and
2. Increasing enplanement figures at a rapid growth rate for many years.

Schedule B from the Airport’s FY 2018-2019 Comprehensive Annual Financial Report shows the last ten years of the CPE. As enplaned passengers increased, the CPE decreased.

Schedule B

NORMAN Y. MINETA SAN JOSE INTERNATIONAL AIRPORT
 (A Department of the City of San José)
AIRLINE COST PER ENPLANED PASSENGER
LAST TEN FISCAL YEARS
 (\$ and Passengers in 000's)



| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|----------------|-----------------|-----------------|----------------|----------------|
| Airline revenues: | | | | | | | | | | |
| Terminal rental | \$ 33,459 | \$ 34,446 | \$ 39,864 | \$ 38,256 | \$ 38,130 | \$ 34,372 | \$ 40,800 | \$ 39,778 | \$ 43,477 | \$ 42,815 |
| Landing fees (passenger carriers) | 12,443 | 12,582 | 10,838 | 12,298 | 11,451 | 11,361 | 12,528 | 17,697 | 18,690 | 18,453 |
| Total | 45,902 | 47,028 | 50,702 | 50,554 | 49,581 | 45,733 | 53,328 | 57,475 | 62,167 | 61,268 |
| Enplaned passengers | 4,107 | 4,189 | 4,125 | 4,235 | 4,517 | 4,765 | 5,088 | 5,740 | 6,725 | 7,462 |
| Airline cost per enplaned passenger (not in 000's) | <u>\$ 11.18</u> | <u>\$ 11.23</u> | <u>\$ 12.29</u> | <u>\$ 11.94</u> | <u>\$ 10.98</u> | <u>\$ 9.60</u> | <u>\$ 10.48</u> | <u>\$ 10.01</u> | <u>\$ 9.24</u> | <u>\$ 8.21</u> |

Source: Norman Y. Mineta San José International Airport audited financial statements and activity reports

Fast forward to today and the worldwide outbreak of COVID-19 that has caused significant disruptions to domestic and international air travel, including passenger, cargo and general aviation operations. Enplanements have declined significantly in March, April, and May 2020.

Fiscal year-to-date passengers through February 2020 demonstrated year-over-year growth of 8.9%. March passenger traffic decreased by 59% while April, and the first half of May, passenger traffic decreased by approximately 96%.

The rapid drop in enplaned passengers causes a greatly changed CPE ratio. The reduction of enplanements caused the CPE to increase. The Airport is conservatively planning for the future and using a passenger scenario for FY 2020-2021 that includes approximately 60% average reduction in enplanements compared to FY 2018-2019. Recovery of enplanements back to FY 2018-2019 levels is estimated to take several years. In discussions with both San Francisco and Oakland airports, all of the Bay Area airports are assuming the recovery back to FY 2018-2019 enplanement levels to occur in FY 2022-2023 or FY 2023-2024. For the FY 2020-2021 estimates, Oakland and San Francisco airports are assuming approximately a 54% and 23% decline, respectively, compared to the FY 2018-2019 enplaned passengers.

ANALYSIS

Given the ongoing uncertainty surrounding the COVID-19 pandemic and the resulting impacts to the general economy, Airport management will continue to evaluate and revise passenger reduction/growth scenarios. Recovery of the aviation industry and passenger traffic will depend on future actions and events such as federal and state responses to the pandemic and the economic contraction.

To effectively manage operation of the Airport, Airport management meets regularly with the airlines to discuss assumptions and future scenarios. The FY 2020-2021 Proposed Operating and Capital Budgets reflect measures to reduce operating expenses and defer and scale capital projects appropriately in response to the rate of recovery in the air travel industry. The discussions with airlines on the FY 2020-2021 Airline Rates & Charges revenue items (Landing Fees and Terminal Rental rates) were positive and well received. The table below shows the Budgeted CPE for all of the Bay Area airports for FY 2019-2020 and FY 2020-2021 as well as the passenger growth assumption used in the development of the FY 2020-2021 budget.

| Airline Budgeted CPE | FY 2019-2020 | FY 2020-2021 | FY 2020-2021 Passenger Growth* |
|-----------------------------|---------------------|---------------------|---------------------------------------|
| San Jose Airport | \$11.55 | \$25.45 | (60%) |
| Oakland Airport | \$11.45 | \$21.08 | (54%) |
| San Francisco Airport | \$19.10 | \$29.31 | (23%) |

**growth versus FY 2018-2019 actual passenger levels*

Despite reducing expenses where possible, the low enplaned passenger figures assumed in the recommended passenger scenario result in a FY 2020-2021 estimated CPE ratio that grew a bit faster than the neighboring Bay Area airports. The CPE ratio requires a prediction of future enplaned passenger figures, and in this unprecedented environment of a global pandemic and shelter-in-place orders, passenger projections are highly speculative. SJC Airport executives are consistently conservative in financial management strategies, plans and actions, including, but not limited to the passenger enplanement scenario used for the FY 2020-2021 Budget and Rates & Charges development (approximately 60% lower than FY 2018-2019, which is more conservative than the assumptions used by Oakland and San Francisco airports).

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Based on the prudent and proactive fiscal approach Airport staff employed to reduce expenditures in both FY 2019-2020 and FY 2020-2021, along with collaboration with our tenant partners to provide immediate temporary financial relief to promote more stable long-term revenue streams, staff recommends that Council rescind the \$11 to \$12 target established in 2010 and direct Airport staff to use its best efforts to maintain a CPE that is competitive with the other airports in the region.

COORDINATION

This memorandum was coordinated with the City Attorney's Office.

/s/

JOHN AITKEN, A.A.E.

Director of Aviation

For questions please contact John Aitken, Aviation Director, at (408) 392-3610