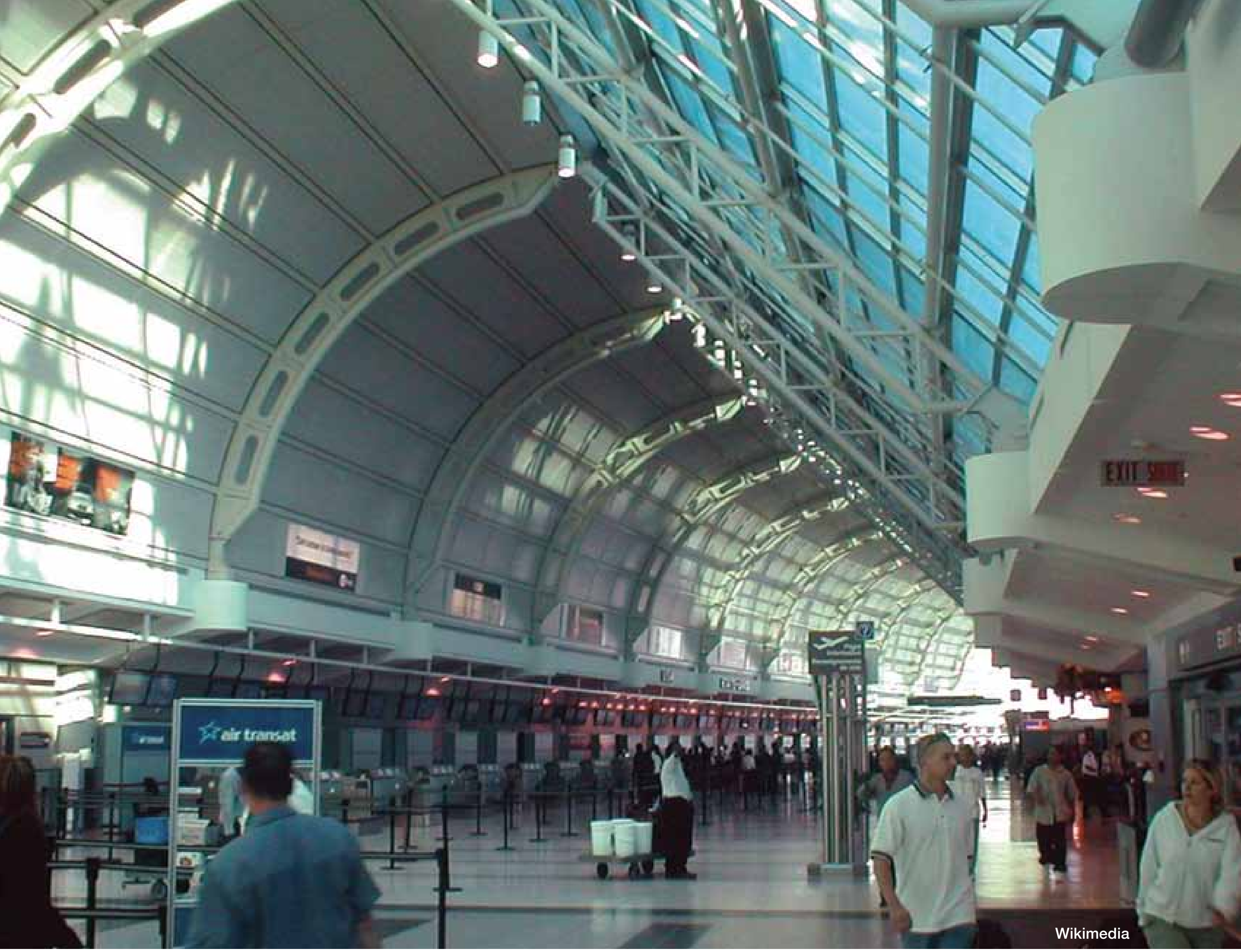

Toronto Pearson International Airport

A new model for managing Canada's airports

Nicholas Hann explains how moving from a not-for-profit model to a concession model for Canadian airports can lead to numerous benefits, including: a multi-billion dollar yield to taxpayers; continued essential capital investment; and reduced reliance on fees and charges from airlines and passengers. Hann suggests the change would also help stem the tide of Canadians crossing into the US in pursuit of cheaper airfares.

Nicholas Hann

Canada's national airports exist in an uneasy no-man's land between government control and commercialization which increasingly seems to be satisfying no one.

Since the National Airports Policy implemented between 1992 and 1994, the Canadian Federal Government has retained ownership of Canada's 26 largest and most significant airports by remaining as the landlord while leasing the facilities to non-share capital airport authorities who are responsible for financial and operational management.

As the landlord under 60 year leases, the federal government collects significant ground rents from the airports but exercises limited other forms of control or influence. The Canadian Airport Authorities are structured as private not-for-profit entities controlled by boards representative of stakeholder interests but directly accountable to no-one. This model, with its lack of clear incentives either from a public policy perspective or in terms of efficiency maximization, has led to a patchwork of differing performance around the country. Some Canadian airports, notably Vancouver International, perform quite well on international metrics within the constraints of the not-for-profit model, and have established successful global subsidiaries. Others, notably Toronto Pearson, have experienced slow growth, have very high debt ratios and charge airlines some of the highest landing fees worldwide.

Canadian airports are funded through the aeronautical revenues they charge airlines using the airport, through commercial revenues generated from the provision of retail and other services to airport users and, increasingly, through Airport Improvement Fees levied on passengers using the airport. They finance their capital expenditures through borrowings in the debt markets taking into account the strength of their revenue streams, their monopolistic position in the marketplace and the implicit support they enjoy as quasi-governmental functions.

To understand this last point, consider whether the federal government could ever allow a major national airport to fail. Canadian airports have large short term and medium term capital needs but typically have underutilized balance sheets, lag international peers in profitability and rely unduly upon aeronautical charges to airlines rather than commercial revenues. This model is coming under increasing pressure in a world in which both airlines and passengers make routing decisions based on cost rather than airport proximity alone and where Canadian airports are increasingly competing for business with US and other international and regional airports. In 2012 over 5 million Canadians chose to cross the border to fly from a US airport rather than use higher cost Canadian facilities.

In a paper published by the Frontier Centre in August 2012, Mary-Jane Bennett is consistent with much current thinking when she concludes that "The not for profit model has constrained rather than enhanced growth and represents little more than an intermediary step before privatization."

The Canadian Airports model stands in contrast to experience in much of the rest of the developed world where responsibility for investment and management has been transferred to the private sector by means of long term concessions. This concession model combines the benefits of retention of public ownership with an improved and more transparent regulatory framework than exists today in Canada and the transfer of the risks and benefits of efficient operation and management to a private sector partner.

Over $32 billion of similar airport concessions have been successfully undertaken worldwide over the past 20 years in the United Kingdom, Europe and Australia and much has been learned about the benefits achievable.

The most striking illustration of the difference between the current not-for-profit model and a concession structure is the immediate value which could be unlocked for Canadian taxpayers. The present value of the ground lease payments, discounted at the current Government of Canada bond rate, is in excess of $8.6 billion. In addition, the surplus value of Canada's seven largest airports, calculated at the average multiple of operating revenues for airport concessions over recent years is some $7 billion. In other words, private investors would be willing to write an upfront cheque of over $15.6 billion for the rights to operate Canada's largest airports at the current levels of efficiency. These dollars could be allocated to other priorities such as deficit reduction or further infrastructure investment to improve Canada's competitiveness.

To further illustrate this unlocking of value from the not-for-profit model, Vancouver International Airport, which on many measures is Canada's best, had net assets as at the end of 2012 of some $1.16 billion. While it is not clear to whom these assets belong under the current ownership and governance model, a concession would value the airport at almost twice as much — almost $2.3 billion.

Now consider the effects that a fully valued balance sheet and a profit-maximizing incentive could have on improved efficiency and operational performance of the airport. A striking difference between Canada's not-for-profit airports and international concessions is the proportion of revenues which comes from commercial revenues. Internationally, this is as high as 65 percent for some airport concessions and averages well over 50 percent. In Canada, by contrast, Vancouver International still relied on aeronautical fees and Airport Improvement Fees for 57 percent of its revenues in 2012 and Toronto Pearson took 75 percent of its revenues from these sources.

This greater reliance on commercial revenues earned by providing services airport users are willing to pay for allows for dramatic reductions in landing fees and other charges which increase airfares and lead to airlines and customers seeking other alternatives. In the United Kingdom, aeronautical fees have decreased significantly since privatization in 1987 under an inflation minus regulatory price cap. Landing fees at Heathrow Airport are now one-third of those in New York City despite tight capacity constraints. There is significant room for improvement in Canada, with Toronto's 2012 per passenger charges amounting to over US $58 and Vancouver's to more than US $34, both high by international standards.

The benefits of concession models can be even more significant for smaller regional airports as for international hubs. Since Macquarie Group's investment in 2001, Bristol Airport in the United Kingdom has seen airline charges decline by 15 percent per annum, driving a 22 percent per annum increase in passengers and growth in commercial revenues of almost 35 percent. The move from a not-for-profit model to a concession model therefore has the potential to release a $15.6 billion surplus to the Canadian taxpayer, support continued essential capital investment, reduce excessive reliance on fees and charges from airlines and passengers and reverse the trend away from using Canadian airports to cheaper alternatives.

Canada's national airports would represent an attractive long term investment opportunity for infrastructure investors amongst whom Canadian pension funds are global leaders. Investors such as the Ontario Teachers' Pension Plan, which has significant investments in international airport concessions, have the capital and expertise to transform the Canadian airports sector in conjunction with management and staff from Canada's best performing airports released from the constraints of the not-for-profit model.

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