

COUNTY OF MILWAUKEE

INTER-OFFICE COMMUNICATION

DATE: May 10, 2018
TO: Supervisor James "Luigi" Schmitt, Chairman, Finance and Audit Committee
FROM: Donna Brown-Martin, Director, Department of Transportation
SUBJECT: Response to 2018 Recommended Capital Budget WA22101 (GMIA International Terminal Redevelopment) Questions

POLICY

A response per the 2018 Recommended Capital Budget WA22101 requesting an informational report with regard to cash flows of Passenger Facility Charges (PFC's), Airport Discretionary Fund (ADF) and airline acceptance of the proposed project.

BACKGROUND

The 2018 Adopted Capital Budget for project WA22101 - GMIA International Terminal Redevelopment, required the Airport Director to report back to the Committee on Finance and Audit various conditions outlined in the adopted budget. During the budget deliberations, the airport provided a presentation regarding the condition and operational issues related to the current International Arrivals Building (IAB) and the condition of the E Concourse, that report is included as Attachment 1. The airport has reviewed this request and has gathered the requested information and has shared this information with the Comptroller's office in a meeting held on January 26, 2018. During that meeting the Airport presented an analysis of 30-year cash flow of PFC funds looking at current PFC projected collections based on current enplanements. In addition, the Airport presented what current and projected PFC commitments are outstanding for other projects and what the PFC terms are for these projects along with other considerations associated with the budget request. The analysis is presented as Attachment 2. The airport also provided similar information for the Airport Development Fund Account as required in the capital budget. That information is provided as Attachment 3 to this report.

30 Year PFC and ADF Analysis

The development of the 30-year cash flows for both the PFC and ADF funds were done with assistance by Unison Consulting, the airport's financial consultant who has assisted the airport in the past with PFC financing. The analysis takes into account current PFC obligations along with currently identified projects in the airports 5-year CIP that may be PFC eligible. In addition, since projects going out on a 30-year basis are largely unknown, there was an annualized assumption of PFC use in later years of the plan. It should be pointed out that there are only certain uses for PFCs and, because of the use restriction, there are some years where very little to no PFCs are used at all.

From the analysis provided as Attachment 2, the lowest level the PFC balance drops to is \$10 million dollars in 2029 and includes the E Concourse redevelopment project in the balance. This balance takes into account anticipated projects and the repayment needs of past PFC projects. PFC backed bonded projects typically are repaid on a 25-year time frame for facility improvements. While there is no predetermined amount that the PFC balance cannot drop below, nor is there any federal restriction that identifies such a level, the balance identified represents a comfortable balance of PFCs to allow for any other unforeseen projects in the future that pop up as an emergency or an immediate need that may require PFC funding. Enplanements

are forecasted to remain level in the 30-year analysis. Currently, airport enplanements are growing at a 2% growth rate.

Similarly, for the ADF fund the lowest level occurs in 2021 when the balance is \$1.8 million. The ADF is defined in the Airline Use and Lease Agreement as an amount of 10% of concessions revenues and allowing for the airport to create a fund up to \$15 million for the discretionary use of the Airport Director. Funds exceeding \$15 million dollars are then returned to the airlines. The ADF is currently depositing \$4.7 million into the fund on an annual basis with projected to increase to \$4.9 million in 2019 and over \$5 million in 2020 and thereafter. The fund is established so that the airport can do projects at its discretion that it deems necessary or important to the airport without airline approval. Currently there is a \$10.7 million balance in the ADF account.

Going forward, the airport and the Comptroller's Office has established a threshold that the PFC and ADF accounts will follow. The PFC balance will be maintained at a minimum of 25% of the prior year's balance and the 15% for the ADF. In no year will there be an ending balance of less than \$1 million dollars for PFC or ADF and no balance within the year will fall to \$0 dollars. The Airport and the Comptroller's Office will review annually updated cash flow forecasts for the PFC and ADF accounts. These assumptions will be interpreted so as to not conflict with any components of the airline use and lease agreement.

Market Analysis and Marketing Plan

In addition to the financial information requested the airport also worked with Ailevon Pacific, an air service development consultant to determine passenger demand. Ailevon Pacific is a firm who employs former domestic and international airline network planners, revenue management, operations, airport air service management, aviation strategists and marketing staff. Ailevon has clients worldwide including airports, airlines, tourism groups, and governments. Their services include air service market assessments, air service catchment area analysis, airline route analysis, air service statistical reporting and assistance with master plan forecasting.

Based on the analysis Ailevon Pacific provided some key pieces of information that has been identified as support for future domestic and international service.

- Milwaukee captures 73% of all domestic traffic originating in its catchment area
- That increases to 81% when there is non-stop service
- Milwaukee captures 35% of international traffic with 65% using O'Hare.
 - Over 540 passengers a day leave Milwaukee and use O'Hare for trips to the Caribbean, Central and South America and Mexico
 - Over 300 passengers a day leave Milwaukee and use O'Hare for trips to Europe
 - Over 125 passengers a day leave Milwaukee and use O'Hare for trips to Asia

Based on travelers leaving Milwaukee and O'Hare, the following suggests support for future international air travel:

- 573 passengers departing each way to the top 25 Latin American markets, assuming a 737 aircraft with 175 seats served a hub destination, would support 3 full flights a day.
- 427 passengers departing each way to the 25 European markets, assuming the use of a 767 aircraft with 225 seats serving a hub destination would support 2 flights per day.
- 138 passengers departing each way to the top 25 Asian markets, assuming the use of a 787 aircraft with 242 seats serving a hub destination would support 1 flight a day.

The numbers used to support travel to international destinations is based on the current level of passengers departing each way from the top 25 destinations for each region. This does not include market stimulation

which would suggest more travelers would use the service if the service was provided. What is represented is a base level of what occurs today. Attachment 4 provides a summary overview of the market analysis findings.

Newer, modern aircraft provide a longer flight range than older aircraft making it possible to serve more cities on plane with fewer seats than the past. This has opened service possibilities to more cities similar to Milwaukee. Milwaukee's cost advantage and proximity to Chicago makes it an attractive market for certain air carriers.

In terms of domestic service, from 2017 to 2018, Milwaukee had service introduced on 16 routes, serving 7 new markets on 2 new carriers. One of those markets being Guadalajara Mexico served on Volaris Airlines. Most recently Salt Lake City has been added on Delta and in March Southwest will begin service to Houston Hobby Airport. Service outlooks remain strong with airlines taking delivery on new aircraft that will expand their fleet capacity and allow for more destinations to be served. Milwaukee's location to Chicago and location within the United States is advantageous for service to be added to either east or west coast destinations.

Marketing to airlines is dependent on the airline, their business model, and the route structure they have in place trying to gain the best advantage for service within that network. Since all airlines are different and provide service to cities in a different way, each conversation is different. If an airline concentrates its service through a hub, we will market our approach to service to that hub that provides for the best schedule times to connect to other cities, or on larger mainline aircraft as opposed to the regional jets. If the airline operates to more direct cities then we will focus more on cities that are not served or underserved by that airline or any other airline. The market incentive program that was recently passed by the board in the January 2018 cycle is an additional tool that has helped add additional service. Marketing to airlines is a multifaceted approach that requires regular contact with airlines in various forms included periodic meetings as events, at their headquarters, or here in Milwaukee.

Authorization Process

In addition, to the two cash flow requests and market analysis, there was request for confirmation of airline approval for this project. It should be noted that per the Airline Use and Lease Agreement, the airlines are not required to vote on this project because the financing of the project will not impact the airlines rates and charges.

AULA - Article VII Section 704(D)

County may proceed with any additional Capital Improvement that does not impact Airline's rates and charges through depreciation or amortization charges.

The use of PFC and airport discretionary funds means that the use of airlines rates and charges will not be used and therefore no vote is required by the airlines and the airlines acknowledge this fact. Airline approval of projects is governed under Article VII of the use and lease agreement. Airline voting is required when a project is added to the 5-year capital improvement plan (CIP). However, a majority in interest vote is only needed when a project exceeds the 5-year CIP cap and impacts the airlines rates and charges.

AULA - Article VII Section 702 states:

The Net Financing Requirement Cap during the term of agreement is established as one hundred percent (100%) of the projected Net Financing Requirement. The total cost of the Five-Year CIP may not be revised without MII approval if the Net Financing Requirement Cap is not exceeded.

The airlines did, however, vote for a project in the 2016-2020 CIP that included a consolidation of the IAB and E Concourse. That project was identified as a \$55 million-dollar project under a former study that looked at both the central security checkpoint project and the E Concourse redevelopment project. That study was updated with the more recent study focusing on just the E Concourse redevelopment.

The current feasibility study identifies the fact that both the IAB and the E Concourse are aging facilities with a need for capital improvements. The study points out that modifications to the IAB would necessitate updates to the facility to comply with current customs standards. These updates would total an estimated \$30 million dollars and would not improve the current operational needs of the IAB. The decision is one of invest in the current IAB which is well documented as an outdated and inefficient facility or make the investment to upgrade the E Concourse to suit both international and domestic needs.

This information has been most recently presented to the airlines at three different meetings, the first on May 4, 2017, the second on November 7, 2017 and the third on January 25, 2018. The airlines agree with the fact that no vote is needed per the terms of the AULA. At the January 25, 2018 meeting with the airlines, they indicated they understood there is a need to modernize the facility and that investing in the current IAB would not make sense given its age and current operational issues. The airlines then asked when the project was planned to begin and when it would be completed and open for service.

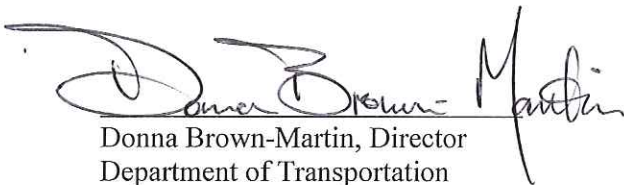
Based on the information provided, the Airport is confident in its ability to move forward with the project financially and is within its authority to do so given the agreed to provisions of the AULA.

RECOMMENDATION

This report is for informational purposes.

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Approved by:


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Department of Transportation

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