

## City of Greater Geraldton – Inquiry into Regional RPT Airfares in Western Australia

The Economics and Industry Standing Committee of the WA Parliament resolved to inquire into airfare prices on regular public transport routes in regional WA. Discussion notes are provided by the City in the following sections, in relation to the particular matters identified by the Committee. These discussion notes have been prepared by City officers and do not necessarily reflect the formal policy views of the City Council. The City owns and operates the Geraldton Regional Airport which supports and enables RPT services on the deregulated Perth-Geraldton route by QantasLink and VARA (Virgin), both airlines currently operating Fokker F100 jets for the services.

### 1. Factors contributing to the current high cost of regional airfares in WA

All of the local contextual factors for every Regional airport location influence RPT fares. To illustrate, and without being exhaustive:

- distance from Perth and other centres;
- availability and cost of fuel at different airports where refuelling is required;
- definition of sectors for fare purposes by airlines;
- ease of substitution to and cost of other transport modes (rail, coach, car), and consequent sensitivity of airfare pricing on passenger demand;
- resident population and recurring passenger demand levels, influencing aircraft sizes deployed, frequency of services, and consequent unit operating costs;
- airport infrastructure capacity and its effects on size of aircraft able to use the airport, again influencing unit operating costs (which may be expressed as cost per passenger kilometre);
- traffic quantum and passenger source mix of an airport – RPT, FIFO, Other Charter, GA – influencing sources of airport revenues and levels of airport charges;
- quantum and range of airport fees and charges on aviation – aircraft landing, passenger services, security screening, and (at some airports) aircraft parking;
- whether or not RPT security screening is required at an airport (for RPT aircraft MTOW over 20Tonnes);
- whether or not security screening is extended to FIFO flights operated through the RPT terminal;
- whether or not a service requires overnighing (with associated costs) of aircraft and crew;
- presence of RPT competition on the route; etc.

Every destination airport, the makeup and size of each community served, every route, is different. The Committee must avoid a simplistic approach to this complex subject.

To illustrate the nature of differences between regional airports, [Appendix 1](#) provides some baseline data on:

- Distances of various regional airports from Perth;
- Annual Passenger and Aircraft movement numbers (BITRE data), as key indicators of scale of airport RPT operations, with date to indicate the changes in RPT activity levels at the various regional airports since 2014; and

- Airfares of the various Airlines between Perth and various regional airports, current as at first week of July 2017.

Appendix 1 also includes some basic analysis on Passenger Fare *Per Kilometre* for a Perth-Return journey, for the range of fare offerings by each RPT Airline, for each of the various regional airports. The data tables are self explanatory, providing a quick compare/contrast perspective on differing airfare levels.

NOTE: The analysis is limited and caution is necessary in reaching conclusions, without further data to make such analysis more robust. It is provided to illustrate the analysis direction possible – and to suggest areas where further data and analysis would be useful. For example, the structure of passenger demand through each airport requires breakdown, to segregate RPT and FIFO passenger numbers. As well, the basic analysis does not include information on aircraft types/sizes providing the services to each RPT airport, as the City does not have immediate access to such information for all other airports. Aircraft type/size/weight determines airport landing fees.

Aircraft type/size and route distance have significant bearing on operating costs per passenger/kilometre. The turboprop aircraft operated by REX for Esperance and Albany, and by Skippers for the Gascoyne/Murchison services, have MTOW<20T and do not attract passenger and baggage security screening, hence operate with lower passenger service charges than the larger Jet aircraft operated by Qantas and Virgin – however, in cost-per-seat terms they are less economical to operate than the larger Jets. The Committee may find it useful to add passenger-type and aircraft-type data to its research parameters with the view to establishing metrics that will enable apples-for-apples comparisons where relevant.

Commercial viability of an RPT service to the Carrier is the ultimate factor determining whether or not a service is introduced and continues. Market presence and share considerations, and a longer view on route and network development may influence a carrier when assessing marginal routes, but ultimately each RPT route needs to be profitable to be sustainable. That requires a net positive paying yield over time across the services provided on each route – not necessarily on every flight – with fares set for the route accordingly, the higher yield services in a particular period offsetting lower yield services on the route. Airlines will take into account factors such as seasonal effects on passenger numbers, a key issue on particular routes, when considering capacity planning re aircraft types and frequency of services. They must also consider the risks inherent in forward bookings, when setting fares, typically seeing a proportion of ticket sales booked 3 months in advance. For regional airports with RPT services including pre-booked block FIFO passengers (as distinct from just closed charter FIFO services), the pricing metrics for non-FIFO RPT airfares will differ significantly from that applied to regional airports that are neither FIFO-source nor FIFO-destination airports.

Pricing of airfares is ultimately limited to *what the market will bear*, having regard to differing levels of price sensitivity associated with different market segments – FIFO, business, visiting friends/family, travel for health or education services, leisure, tourism etc. Presence of competition between Qantas and Virgin on a route clearly influences fare considerations – currently including all regional airports with over 100,000 annual passenger movements.

Ease of substitution to other transport modes is a key factor in fare sensitivity, particularly for airports within 400km (as the crow flies) from Perth - Geraldton and Albany – where air services compete with road travel by Car, most particularly impacting travel by families with children. From the Albany and Geraldton experience in recent years, closeness to Perth and ease of substitution to car travel will be a significant issue for development and viability of future Busselton-Perth RPT services.

RPT airlines generally pass Airport charges – aircraft landing fees, passenger service fees, and security screening fees, on to their passengers.

As a general condition of provision of funding support for the original acquisition of mandatory security screening equipment at regional airports, the Commonwealth indicated that regional airports should avoid making 'profit' from passenger and checked baggage security screening fees, seeking to recover security screening costs only. The level of security screening costs is largely determined by stringent Office of Transport Security (OTS) requirements, in relation to the specifications of equipment required and, for example in relation to the number of trained security screening staff required when security screening is in operation. Geraldton airport owns, provides and maintains all of the passenger and checked baggage screening equipment, but out-sources the operational delivery of security screening via a public tender process, so its costs of security screening reflect the broader market, aimed to achieve best value for money. Geraldton sets its mandatory security screening charges to recover those costs across RPT and Charter passengers.

The airlines refer to airport aviation fees and charges collectively as 'head taxes'. Issues previously canvassed as part of framing of the current State Aviation Strategy had a strong focus on the level of aviation fees and charges at Regional airports, but failed to adequately consider the whole picture. Airport charges at both departure and arrival airports - hence *at both Perth Airport, and at regional RPT airports*, directly impact the level of regional RPT airfares.

*The Committee should examine the impact of the complete range of Perth Airport Fees and Charges on airfares for Regional RPT services. The study should not focus only on aviation fees and charges at the regional airports.*

In theory, Airports should set charges to generate sufficient revenue to cover the costs of airport operations and maintenance, costs of compliance with CASA and OTS requirements, costs of provision of passenger facilities and amenities, and generation of funds for renewal of infrastructure and facility assets. In practice, as reported by the Australian Airports Association (AAA), a significant majority of regional airports across Australia (over 60%) operate at an accounting loss, with annual cash deficits, their annual operating losses subsidised by their owning Councils from ratepayer funds. Many smaller regional airports and their owner Councils struggle to cover costs of airport operation and maintenance, and cannot generate revenues to finance asset renewal.

Already confronted with legacy backlogs of capital asset renewal (a nation-wide issue across the Local Government sector) and with demands from ratepayers for facilities, amenities and services, many Councils have limited financial capacity to subsidise airports, but persist in doing so, at least to the extent possible within their constrained fiscal means, as a community service obligation.

That problem is exacerbated by inability of many regional airports to generate airport revenues from non-aviation activities, because their local populations are simply too small to support initiatives like investment in pay parking, or terminal food sale or other retail franchises within airport terminals. Further, the nature of smaller local economies simply doesn't lend itself to initiatives such as business parks on their airport estate, as a means to generate non-aviation revenue.

The issue of funding for major aviation infrastructure asset renewals has emerged as a growing problem as time has elapsed since the original ALOP transfer of regional airports to Councils, with infrastructure such as runways (many of WW2 origin) now requiring capital renewal, rather than remaining structurally and operationally viable from operational maintenance alone. With airfares already high, and passenger numbers low, many smaller Councils cannot increase Airport charges on airlines, flowing through to fares, without seriously impacting the viability of already marginal RPT services. Unable to finance airport asset renewals from either airport revenues or ratepayer funds, many smaller Councils are increasingly dependent on government grants just to maintain the operational capabilities of their airports. The downside is that the longer that

essential renewal of major assets like runways is deferred, the greater the cumulative load damage to the pavements, the higher the cost of repair and maintenance, and the higher the capital costs of eventual renewal. While the Commonwealth provides a modest degree of financial assistance to *Remote* regional airports, the State's fiscal stress has prevented it funding major airport infrastructure renewals via either RfR or DoT's relatively modest RADS program.

What is clear is that, in the absence of some Federal or State capital funding assistance for renewal of mission-critical aviation infrastructure assets like runways, the operators of smaller regional airports in WA will inevitably have little option than to consider either:

- restricting operations to smaller aircraft types on their pavements, and suffer exponentially increasing maintenance costs over time instead of renewal, potentially precluding RPT services - or even *closing* their airports; or
- increasing airport aviation charges significantly – forcing increases in airfares, probably driving down passenger numbers, forcing more people to be exposed to long distance driving risks, and threatening viability of RPT services, even on regulated routes with an exclusive service license from the State.

DoT's proposal to the previous State Coalition Government to create a new scheme – the proposed *Airports Infrastructure Renewal Scheme* (AIRS) – failed to get then-Government support via RfR funds. The view of CGG is that it is worthy of consideration by the new Labor Government, as an initiative to assist regional airports avoid significant increases in airport fees and charges, driving up airfares – while ensuring the continuity of regional air services by ensuring appropriate and safe aviation infrastructure remains available to sustain those regional air services.

Introduction of security screening of passengers and checked baggage on RPT services via aircraft with Maximum Take Off Weight (MTOW) over 20Tonnes had an immediate obvious impact on passenger numbers, with airfares increased to cover the new costs of security screening. Unfortunately, for some RPT airports used to services by aircraft with MTOW>20T, but with relative low passenger movement numbers, the unit costs of providing security screening services, in compliance with OTS standards, were very high, with immediate impact on airfares. This impacted passenger demand levels at airports such as Esperance and Albany. The combination of high airport charges, lower passenger demand, and withdrawal by Virgin of its F50 turbo fleet saw their withdrawal from the Esperance and Albany markets, with subsequent transition to REX using smaller aircraft types with MTOW<20T not attracting security screening services and charges.

Geraldton – like Albany – experiences ease of substitution to car travel to and from Perth. Opening of Indian Ocean Drive reduced the car travel time Perth-Geraldton to about 4 hours. Parents with Children will drive rather than fly because of aggregate cost of fares for the family. Business people will drive because of the combination of airfare levels and service scheduling. If they fly they typically cannot do a full day of business in Perth, without having an overnight stay, adding to lost business time and fiscal costs. The effect of substitution to car travel is to reduce RPT passenger numbers, thus increasing unit costs of security screening services, and creating pressure to increase aircraft landing and passenger service fees.

Reduced passenger demand inevitably results in changes by carriers to the frequency of services, to maintain a viable average yield for the aircraft type. If the carriers do not have smaller aircraft types in their fleet, that typically sees withdrawal of particular services, and decreased service frequency. With departure of Virgin F50 and QantasLink Q400 turboprop types from the fleets deployed in WA, with increased use of F100 and B717 jets for RPT services, reduced frequency of services by both carriers has been the result on the Perth-Geraldton route with the regional slowdown since 2013.

To avoid exacerbating the problem of declining passenger numbers, by adding to airfare pressures, *the City of Greater Geraldton has 'frozen' its aircraft landing and passenger service charges on airlines for the past three (3) years.* A modest increase in security screening fees has been introduced for 2017-18, to recover increases in the contracted costs of the out-sourced security screening operation, but landing fees and passenger service fees have remained frozen. This has obviously impacted the revenue earnings of the airport, with operating costs escalating in the usual way from inflation (and increased State utility charges), further constraining capacity of the airport to generate funds for infrastructure renewal, increasing its reliance on capital assistance from Federal and/or State governments.

## 2. Impacts that high-cost regional airfares have on regional centres- from a business, tourism and social perspective

Impacts on regional businesses do not accrue just from the level of airfares. The combination of availability of services, airfare costs, and the timing and frequency of scheduled RPT services, impacts business travellers. The cost and elapse time of the full travel experience from home departure to home return requires consideration.

The following notes are not exhaustive – they address a number of issues regarded as being significant from the perspective of Geraldton

### **Business Impacts:**

- Total cost of air travel (as distinct from the level of airfares alone) impacts Geraldton businesses doing business in the Pilbara or Kimberley. To travel to Karratha, Port Hedland, Newman or Broome, business travellers can only catch flights from and to Perth for those destinations. They cannot fly direct from and to Geraldton to any airport other than Perth. Thus for example their travel costs will include fares for Geraldton-Perth-Pilbara and Pilbara-Perth-Geraldton, each time crossing multiple fare sectors. As well, scheduling of Pilbara or Kimberley services in either direction, and scheduling of services on the Perth-Geraldton route, may mean overnight stays in Perth and/or the Pilbara, adding to overall journey time and direct cash costs for accommodation and meals. In that context, Geraldton businesses doing regular business in the North West would pay relatively high fares for direct Geraldton services rather than always having to fly everywhere via Perth. However, surveys by both the City and the MWCCI confirm the understanding of the carriers – there is insufficient current demand to justify services from Geraldton to Pilbara or Kimberley destinations.
- Scheduling of services by QantasLink and Virgin on the Perth-Geraldton route reflects carrier assessment of demand days and times, as well as management of their slots at Perth Airport. For the purposes of an early morning flight to Perth aimed at outbound business travellers, neither carrier is currently willing to overnight an aircraft and crew at Geraldton, claiming insufficient demand to justify the incremental costs. Scheduling of afternoon Perth to Geraldton flights typically requires getting to the airport well before end of Perth business hours. Hence Geraldton-based business travellers frequently opt for an early morning 4-hour drive to Perth, to get a full day of business, then have a 4-hour drive back to Geraldton to avoid an overnight stay in Perth and loss of business time the next day. Eight-plus driving hours, for a business day in Perth, with the associated risks of road travel, particularly at night for their return journey. It's not the level of airfares that drives this behaviour – it's the absence of services by either RPT airline scheduled to meet the optimum days and times for business travel. Cost of an overnight stay and loss of valued business time next day are the key factors for Geraldton businesses.

### **Tourism impacts:**

- Geraldton is not currently a major air travel destination for tourists. Most intrastate, interstate and international tourists visiting Geraldton travel by road – either their own or hired vehicles. Much like the Capes Region, a lot of the tourist attractions in the CGG region require road travel and the convenience of a self-drive vehicle.
- It is the case that the convenience of car travel and relatively high airfares on the Perth-Geraldton route deters domestic tourists from flying.
- For tourists inbound to WA from Europe via Perth on Qantas services, and seeking to fly to Geraldton, or indeed to Pilbara destinations, fare packaging simply adds a sector fare to their overall airfare cost (understood to be less than \$40 – but that detail requires confirmation), so for International tourists from Europe flying Qantas, the high level of domestic intrastate airfares is not a deterrent to air travel to Geraldton.
- Geraldton-Perth route only offers point-to-point return services by QantasLink and Virgin.
- To fly to any other tourism destination (e.g. Shark Bay, Exmouth, Broome) any RPT passenger that travels by air to Geraldton has to first return to Perth to catch a flight out from Perth. Hence a tourist wishing to fly the major centres of the Coral Coast cannot do it within sensible measures of time and fare costs. International and Interstate tourists wishing to see the Coral Coast thus tend to bypass Geraldton. That is expected to change considerably, with planned opening of the iconic Abrolhos Islands to tourism. The relatively rapid growth of tourists to Geraldton from mainland China and Hong Kong over the past two years, indicates significant potential growth, and such growth would be enhanced if Qantas replicated the same sector-fare packaging for its services into Perth from China, as enjoyed by Qantas passengers from Europe. Tourism would be further enhanced by introduction of multi-leg return services out of Perth (e.g. Perth-Geraldton-Exmouth-Karratha), providing potential for combined growth of business and tourist travellers.

### **Social impacts:**

- For people living in the regions outside Metro Perth, Airports – and not just the RPT airports - play an important role in social connectivity.
- Regional RPT airports play a hub role for Charter services and GA operations connecting the non-RPT airports in their regions. Geraldton for example has two resident carriers – Geraldton Air Charter, and Shine Aviation – servicing the tourism, mining, agriculture and social services sectors across the Mid West, Murchison and Gascoyne regions. The same regional hub airports enable Border Protection, Law enforcement, Search & Rescue, RFDS and Emergency Services aviation operations. The more remote a centre is, the more significant the role of its airport for access to human services, and social connectivity – and the more significant the role (for the remote community) of the regional hub airports, typically the RPT airports, that enable the essential charter and GA operations.
- The higher the airfares between Perth and the Regional RPT hubs, the less the hubs can be effective for enabling connection for remote communities via Charter and GA operations. Aggregate cost of air travel forces remote residents to travel very long distances by road, with associated accident risks on rural roads. Hence the Committee should not confine its examination to social impacts of high airfares on just the immediate communities of regional RPT airports; rather, examination should extend to the catalytic social impacts on remote communities that are dependent on connection of their communities via Charter and GA operations that are dependent on the RPT hub airports.
- Average families with children cannot afford air travel on the Perth-Geraldton route so they incur time costs and exposure to higher accident risks from long distance road travel.
- Higher airfares mean higher costs are incurred by the State for providing access by regional patients to specialist medical services in Perth.



### 3. Impact of State Government regulatory processes on the *cost and efficiency* of regional air services

State Govt regulatory powers over RPT services are relatively limited – largely confined to regulatory oversight and local control over Intrastate RPT passenger services via licensing of carrier access to particular routes. Aviation-proper is a Federal domain. The Commonwealth, not the States, issues RPT operator licences. CASA, OTS and Air Services, administer, oversee and service Aviation - not the States.

A supplementary question worthy of pursuit by the Committee is the impact of Federal Government regulatory processes and cost recovery levies on the costs and efficiency of Airports and Airlines in WA, with particular regard to the responsibilities, functions and budgets of Air Services Australia, CASA, the Office of Transport Security, Australian Federal Police, Border Protection Service.

Costs of Airlines operating through Perth Airport have a direct impact on the cost of Regional airfares in WA. Those costs include Federal fees and charges paid by airlines, and the fees and charges on Airlines by Perth Airport.

Interference/ intervention from the State in aviation commerce should be minimised, and intervention in aviation operations by the State would breach Federal aviation laws, outside State jurisdiction.

The Australian Constitution gives state and territory governments power over regional (intrastate) aviation as it is seen *largely as an issue of intra-state trade*. In the States where intrastate RPT routes are regulated, those State governments have traditionally placed emphasis on both social and economic connectivity of regional communities – not just Business connectivity. Licensing of intra-state aviation service routes is administered respectively by New South Wales—Transport New South Wales; Queensland—Department of Transport and Main Roads South Australia—Department of Planning, Transport and Infrastructure; Western Australia—Government of Western Australia Department of Transport.

Notably, intra-state air services in Victoria, Tasmania, Northern Territory and the Australian Capital Territory are *fully deregulated*.

Queensland State Government provides financial subsidies to residents in Far North Queensland (Cape York and the Torres Strait Islands). The scheme “...aims to improve the standard of living of local residents by making air travel to neighbouring communities to access health, education and employment facilities more affordable. To be eligible for the scheme, local residents are required to provide a letter from their local Council to prove they have been a resident in Cape York or the Torres Strait for a minimum of 3 years” (Qld Govt website).

Deregulation of intrastate air services routes, allowing market forces to determine provision of regular passenger services, should remain the State’s overarching in-principle objective. Re-regulation of currently *deregulated* RPT service routes should be avoided.

Regulation of any RPT route should be avoided unless the State wishes to intervene legitimately in response to *demonstrated market failure*, by regulating services via granting an exclusive route service license to a single carrier, in order to guarantee continuity of RPT services to at least minimum critical service levels for a particular community.

For regulated routes, definition of ‘minimum critical service levels’ for particular regional communities requires experienced pragmatism in relation to aircraft capacity allocation, and service frequency. The gaps between community expectations (on matters such as service choice, time and frequency of services), actual persistent passenger numbers and trends, and commercial viability of a service level, need to be understood in the process.

Service capacity and frequency based on pragmatic assessment of sustainable passenger demand levels, falling short of unrealistic community expectations and preferences, does not necessarily constitute market failure. Nor do seemingly high airfares necessarily represent 'market abuse' by carriers.

Re-regulation of regional routes, with the view to licensing exclusive rights to a single carrier for up to five (5) years, in return for both guarantees of service levels and service continuity, *combined with any imposition of a degree of State Government control over air fares*, would represent an inappropriate intervention in the market, with real risk of withdrawal of airlines from servicing a number of regional airports in WA being the most likely outcome.

Unless the State undertakes to *provide financial subsidy* in order to guarantee an agreed service level (capacity and frequency) then the risk – and hence the commercial decision making imperative - rests wholly with the Carrier. Unless the State has fiscal skin in the game, sanctions for under-performance against exclusive route licences are difficult/impossible to impose. No sensible carrier would (nor should) enter an exclusive service license for a regulated route, with sanctions on under-performance, without de-risking capacity allocation and service frequency commitments – and de-risking any price capping imposts on airfares - via some sort of financial subsidy from the State to cover declines or periodic fluctuations in passenger demand. The publicly stated guiding position of the previous State Coalition Government (reflected in its first-ever State Aviation Strategy) was not to provide subsidies to carriers. The Labor Government may need to re-visit that fundamental question.

In relation to State impacts on the efficiency and cost of regional air services, there is room for the view that it is not so much the *regulatory* processes per se that are at issue; rather, it is how the Policy and Strategy position of State Govt influences administration and decision making via the regulatory processes on regulation of intrastate RPT routes. The current State Aviation Strategy should be subject to comprehensive review by the new Labor Government.

The report from the Regional Airports Study commissioned by DoT under the previous Coalition Government, and undertaken by The Airport Group (TAG), has yet to be released to Airport stakeholders. It should be released seeking comments/input to owners/operators of the regional airports included in that study, and a final report assembled, to inform State Government on a range of issues relevant to the matter of airport and air route planning, informing the necessary review of the State Aviation Strategy.



#### 4. Actions that the State Government can take to limit increases to airfares without undermining the commercial viability of RPT services

This question ought not be viewed by the State Government and its agencies in isolation from the question of *Viability of Airports*, with specific regard to both economic and social policy objectives of the State.

Air transport is about more than RPT services. Without safe airports with essential infrastructure and facilities, the RPT airlines, RFDS, aircraft for emergency services, aircraft for mining exploration and transport of the FIFO mining workforce, aircraft for Agriculture, and General Aviation, cannot fly. No airports – no air services. The viability of Air services for Regional Communities is as much dependent upon the *technical and financial viability of regional airports*, as it is on the viability of services for the RPT airlines, FIFO carriers, other charter carriers, emergency and other essential service providers, and general aviation – on which many more remote communities depend. For regional communities, air services have a strong social policy grounding, and there are clear tensions between the social policy goal of maintaining essential RPT air services for regional communities, and ‘best’ allocation of economic resources.

One thing that observers will quickly realise is that the WA State Government is not and has never been in the business of building, maintaining and operating airports in compliance with International and Federal requirements – let alone operating airports anywhere in regional WA. The WA State Government has never been in the business of operating airlines or providing air services. They are in neither the Aviation nor Airports businesses. In relation to aviation and airports, it is simple fact that the State lacks the strategic and institutional capacity that, in contrast, it may arguably boast in relation to road and rail transport. State agencies are not best positioned to respond to aviation issues other than in direct and deep consultation with Airport Owners/Operators and the Aviation industry, and they demonstrably require the assistance of specialist aviation consultants in the process. To their credit, the small aviation team in DoT endeavours to consult and collaborate with airport owners/operators, but it is fair to say that they are constrained in their efforts by the modest people and financial resources dedicated to Aviation in DoT. Aviation is important to the State and, having regard to the geographic size of WA and its dispersed population settlement patterns beyond Metro Perth, Intrastate air services providing economic and social connectivity for regional communities and industries are arguably more important in WA than in any other State or Territory. The level of resources dedicated to aviation in DoT should reflect that importance. If the Government – and the Parliament - wishes to be well informed and receive good policy and strategy advice on aviation, including capacity to monitor regional aviation services on matters such as airfares, then DoT should be given *additional resources* to enable it to do so. In the current process of rationalising the State public sector, care needs to be taken to ensure that the aviation unit in DoT is protected and, if anything, bolstered with additional resources.

The Committee might usefully note that Regional Councils have been in the business of owning and operating airports, and developing and managing relationships with RPT airlines and other aviation operators for about 40 years. It is certainly the case that for airports servicing small regional communities, their small Councils with limited people and fiscal resources struggle to do it as well as larger Councils, but it is the case that larger Airports in the regions are well planned, managed and operated.

In the context of easing demands on State finances for capital assistance for regional airports, the State Aviation Strategy advocates greater participation by the private sector in the ownership and/or operation of regional airports. The fundamental problem is that with the

exception of the larger regional airports with significant passenger and aircraft movement numbers, few of the remaining regional airports in WA generate sufficient revenue to be commercially attractive to the private sector.

The recent process resulting in leasing out of Port Hedland Airport to the private sector did attract strong commercial interest. However, it is unclear where the airport turnover and growth potential threshold sits, below which operation of an airport as a Profit-making and Tax-paying commercial operation would become commercially unattractive.

This City has consistently argued that means other than sale or lease-out need to be explored, to enable private capital participation (other than debt capital) in regional airports.

An obvious downside of privatisation of any smaller airport is its change from operating essentially as a NFP Council entity, to being a profit-earning and tax-paying entity. Regional airports in the hands of Councils do not pay State land tax, and do not pay Federal income tax or GST. Adding those taxation expenses, and Council rates, to the operations of an airport must inevitably drive up the revenue requirements of the airport in order to deliver a reasonable after-tax ROI to the operator. Hence this City has argued that there are Social benefits in retaining the ownership/operation of regional airports in local government hands. What is needed is a statutory mechanism that also enables private capital participation. The current Local Government Act provisions for 'regional subsidiaries' do not envisage trading entities, do not allow private capital participation, and do not allow borrowings for airports using airport assets as loan security. New provisions in the Local Government Act should be explored to remove these constraints, and enable private capital participation in regional airports remaining in the hands of local governments.

DoT's aviation team has invested considerable effort in the past 2-3 years to get regional airports in WA to improve their airport master planning and, in particular, their asset management planning, to establish a more robust base for essential financial planning for regional airports. Again, the larger regional airports generally have the management and fiscal capacity to do this better than the smaller airports. But it is the RPT services through the smaller airports, unable to offer any scale economies in setting fees and charges, that are most vulnerable. Hence, ongoing assistance from DoT should be supported by the Government.

The idea of sharing of resources between regional airports, as an approach to reducing operating costs, suffers the impediment of distance – they are simply too far apart for practicable and cost-effective resource sharing.

Various ideas have been floated in recent years for consideration by the State including:

- Giving priority to social objectives ahead of economic objectives, and providing a subsidy to carriers providing services on regulated regional air routes, to keep airfares affordable for regional communities. This idea is at odds with the themes of the current State Aviation Strategy. The previous Government viewed such subsidies as being a last resort only, for exceptional circumstances. The new Government should re-visit that question.
- Re-regulating currently deregulated routes, offering them via public tender to a single carrier with exclusive rights, one condition of which would be the State having a degree of price control over the carrier, in setting of service levels and airfares. This City believes that deregulation, allowing the open market to operate, is the preferred position – but notes that priority social outcomes may depend on a degree of intervention by the State. Hence the Committee ought to examine this option.

## 5. Actions that the local government authorities can take to limit increases to airfares without undermining the commercial viability of RPT services

Only a small minority of regional airports in WA operate at a true commercial or commercial-equivalent operating profit, including full recovery of capital costs enabling provision of funds for capital asset renewal. The majority of regional airports in WA operate at a real accounting loss. As is the case nationally (as reported by the AAA) a good proportion of regional airports cannot generate sufficient funds to cover the costs of day to day airport operations and maintenance, requiring subsidy from municipal funds by their owner Councils. It is only the larger regional airports in WA – most probably those with annual passenger movements over 300,000 with numbers boosted by FIFO services rather than just RPT - that generate sufficient real accounting profits to be able to cover all operating costs plus generate funding for all of their capital asset renewal demands (including major projects like main runway renewal).

Airlines persistently argue to the ACCC and the Productivity Commission that the setting of regional airport aviation fees and charges in Australia should not generate a profit that exceeds the ROI cap applied in the so-called 'light touch' regulatory oversight of privately owned or Federal leased-out Capital City airports. Annual regional airport profits beyond that capped ROI might be held to be excessive, and might reasonably be argued by the Airlines to constitute price gouging by the airport owners, with airport aviation fees and charges forcing airfares to a level higher than would otherwise be necessary.

On that point, Airlines have previously made submissions to Commonwealth ACCC and Productivity Commission inquiries, arguing for imposition of an oversight regime on Regional Airports similar to that imposed on the Capital City airports, to prevent alleged market abuse by some regional airport operators wielding 'unregulated monopoly powers'. Federal agencies have noted that the Airlines (as very large commercial corporates) have more than adequate countervailing market powers, with unregulated discretion to withdraw services, or reduce capacity, or alter frequency and scheduling of services – which they do, in regional Australia as and when they see fit, typically without prior consultation with airport operators. Federal inquiries to date have found that RPT airlines are easily positioned to counter any inappropriate exercise of monopoly-like powers by the very much smaller entities (regional local government councils) that own/operate most regional airports in Australia.

Airlines have argued further that, in defining a capped ROI level for regional airports for the purpose of setting aviation fees and charges, the value of gifted assets from the Commonwealth (at ALOP handover), and subsequently acquired airport assets resulting from State capital funding grants, should be excluded from the asset value of the owning Councils, only allowing Councils to derive ROI on assets resulting from Council own-capital allocations. That of course is a flawed proposition. Access to grants enables a Council to avoid borrowing capital funds, hence avoiding interest expenses for the airport which would otherwise be a legitimate expense applied in determining profit/loss, and directly impacting ROI, influencing price setting. An airport avoiding capital financing expenses works to the advantage of airport users, not to their disadvantage. As well, regardless of the fact that owner Councils may from time to time be gifted aviation infrastructure assets or funding to create new/replaced assets, the capital costs *must still be recovered via depreciation charges*, as the assets are consumed over their useful working life, to establish provisions for future asset renewal or replacement by the airport owner/operator. That particular airline proposition is thus flawed. However it is the case that Airlines take Capital City airports to the ACCC when objecting to inclusion of particular assets in their asset values for ROI purposes. This provides useful insights to how the airlines view the matter of airport fees and charges, and their impact on airline operating costs – hence on airfares. To the Airlines this is a mission-critical issue.

It is known that at least one major RPT Airline has disputed the level of aviation fees and charges with at least two regional airport operators in WA, refusing to pay increased charges, asserting price gouging in setting of airport aviation fees and charges. The Airline in question alleged (to the affect) that the owner Councils were pricing excessively to use their airports as cash cows to subsidise the funding of municipal services, to keep Municipal Rates down – while forcing airfares up, to the ultimate disadvantage of all of their residents and ratepayers, and with airline passengers in the first instance effectively subsidising municipal services to the broader community. Threats of litigation appear to have resolved the issue between that airline and the airport operators. If true in fact, with regional airports charging excessively high fees and charges, then the logic of the airline proposition is compelling from the aviation services standpoint. In pragmatic terms, we have two legitimate and compelling propositions in direct tension, since it is perfectly legitimate for Airlines to seek reasonable fees and charges, and equally legitimate for a Council to operate a commercial enterprise with the view to generating funds to apply to municipal services, seeking an appropriate ROI on their assets. The matter resolves to focus on determining an appropriate ROI level. When does ROI for a regional airport become excessive? And which airport Assets should legitimately be included/excluded from the investment quantum for the purposes of determining a capped ROI for the purposes of airport price setting?

For profit-making regional RPT airports, the takeaways from the dialogue above should be pretty clear. Setting aviation fees and charges based on excessive airport ROI target levels (say, over the cap set for Capital City airports) simply fuels the argument of Airlines regarding abuse of airport market power over carriers, and forcing up airfares. The reality for smaller RPT airports of course is that targeting an ROI in the order of (say) 8% is simply out of the question, immediately threatening the viability of RPT services. The problem is exacerbated where there is clear ease of substitution to road travel (e.g. Geraldton, Albany) and very high consumer sensitivity to airfare levels. Owner Councils must therefore be sensitive to the effect of airport fees and charges on airfares, the consequent effects on passenger numbers, and the flow-on impact to service viability. Most regional Councils see RPT services as essential for the community, hence there are social policy considerations in their airport price setting. With the downturn in regional economic activity since 2013, and decline in passenger numbers, the aircraft landing and passenger service fees at Geraldton Airport have been frozen for three successive years.

In submissions to past Federal inquiries, airlines have advocated the introduction of multi-year commercial agreements with regional airports, similar to those in place with Capital City airports, on the matters of airport service levels and airport aviation fees and charges. There are several issues for owner Councils in such an approach. The commercial negotiating capacity/strengths of major airlines on one hand, and small regional Councils on the other, are very different. Airlines have a mobile asset base, with ease in redeployment of capacity, and demonstrated willingness to shift capacity as they please. In contrast, airports are long-life fixed assets, easily stranded or under-utilised by the decisions of airlines. The more marginal an RPT service in commercial terms, the more vulnerable an airport to loss or reduction of services, and the weaker the airport negotiating position. Local Governments owning and operating regional airports, set aviation fees and charges as a mandatory statutory process via the schedule of local government fees and charges in the Council's annual budget. In past years that may have presented an obstacle to multi-year agreements with airlines. However, with the more recent regulatory requirement for Councils to have in place 10 year long term financial plans, and 3-5 year corporate business plans, the mechanisms are in place to enable an owner Council to consider entering a 2-3 year commercial agreement/deed with airlines. Some larger regional airport owners will have the professional executive capacity, and fiscal capacity to retain industry specialists to assist in the process of negotiating such agreements with the airlines. However, smaller Councils operating airports with relatively low passenger numbers may not have such capacity and alternative approaches – not necessarily with direct State agency participation, but perhaps with State financial support - may be necessary to ensure that they are not disadvantaged by the overwhelming negotiating position of the airlines.

**6. Actions that airlines can take to limit increases to airfares without undermining the commercial viability of RPT services**

RPT airlines are commercial corporate entities with shareholders, financiers, and aviation alliance commitments. They operate in a highly competitive international and domestic environment with exposure to major risks, including fluctuations in global geo-political and economic conditions and global commodity (esp. oil) prices. ICAO and IATA reports across recent years demonstrate that most carriers operate on very tight margins, only a minimum globally operate at a real profit. Their forecasts suggest continuation of tight margins and even greater competition, as new carriers take advantage of availability of newer more efficient aircraft types and older carriers transition their aging fleets to the new types.

Commercial viability over time is the legitimate expectation of airline stakeholders. The Ansett experience has taught the aviation industry, the finance sector – and Government – key lessons about the pitfalls of carriers trying to maintain any network of unviable services. Regional airports including Geraldton suffered significant financial losses (unpaid aviation fees and charges) when Ansett collapsed, and regional communities were impacted by loss of services to which they had become accustomed. Skywest provided regional services for many years, before takeover by VARA/Virgin. In regional WA, focus for aviation development across the past 20 years or so has been on growth of FIFO services for the resources sector. While FIFO will remain as an important part of ongoing mining and gas operations in the State, the transition from a peak in investment in new mine development, to production, has seen decline in FIFO demand since 2013. Qantas acquisition of Network Aviation, and Virgin acquisition of Skywest, saw both majors acquire fleets that previously had significant FIFO deployment, but subsequent decreased demand created opportunity to redeploy some FIFO aircraft types to RPT services. Hence for Geraldton-Perth for example, both airlines transitioned services from 50-75 seat turboprop types, to 100-seat jets. Service frequency was decreased, but a faster, better quality of services was introduced, so consumers benefitted from operation of a more economical aircraft type. That no notable decrease in airfares on the Perth-Geraldton route resulted from that change, reflected the realities of the entry of QantasLink into the market – quickly taking a half share of passengers – and leaving each major with about 60,000 annual passenger movements via Geraldton. As a measure of where airlines see competitive 'viability', Virgin withdrew from Learmonth, leaving it to QantasLink, once annual passenger movements dropped below about 90,000. Virgin made a clear statement about route viability for over 20 Tonne aircraft types (subject to RPT security screening) when it withdrew from Esperance and Albany, with withdrawal of its F50 fleet from WA operations. That left room for entry of REX, operating smaller aircraft types on those vacated routes. The process of rationalising fleets and services is ongoing, primarily driven by commercial realities – and governments would do best to leave it to the market.

In the WA regional market, entry of REX changed the dynamics of the smaller RPT carriers operating in the 18-40 seat aircraft space, typically all under 20T MTOW, avoiding mandatory RPT screening, and removing that cost pressure item from airfare setting. Withdrawal of the RPT majors from regional airports with passenger movement numbers inadequate to support services by 100-seat jets has created opportunities for the regional carriers like REX and Skippers to enter more routes, creating opportunities for them to develop service networks across multiple smaller regional airports. Intra-regional services can thus evolve. That process should be encouraged by Government. When current licences for exclusive services on regulated routes next expire, wider opportunities for network development and multi-leg intraregional services should be explored by the State, inviting competitive bids from the regional carriers.

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## Appendix 1

### BASELINE DATA – WA REGIONAL AIRFARES INFORMATION AVAILABLE ON AIRLINE WEBSITES

TRAVEL DESTINATION FROM PERTH ( <b>AND RETURN</b> ) * Route not available	One-Way Distance	Virgin	Virgin	Virgin	Qantas	Qantas	Rex	Rex	Rex	Rex
	Kms	Getaway	Elevate	Freedom	Red e- Deal	Flex	Net	Saver	Biz	Flex
Exmouth (Learmonth LEA) - 6 July 2017	1096	*	*	*	\$818.00	\$1,018.00	*	*	*	*
Onslow (ONS) - 4 July 2017	1150	*	\$598.00	\$1,198.01	*	*	*	*	*	*
Geraldton (GET) - 6 July 2017	371	*	\$378.00	\$558.01	\$449.00	\$612.00	*	*	*	*
Esperance (EPR) - 13 July 2017	602	*	*	*	*	*	\$339.22	\$405.22	\$658.22	\$719.82
Karratha (KTA) - 6 July 2017	1250	\$914.00	\$974.00	\$1,350.01	\$1,027.00	\$1,454.00				
Albany (ALH) - 7 July 2017	392	*	*	*	*	*	*	\$391.07	\$589.07	\$655.07
Port Hedland (PHE) - 6 July 2017	1648	\$844.00	\$913.00	\$1,328.00	\$882.00	\$1,424.00	*	*	*	*
Kalgoorlie (KGI) - 7 July 2017	538	*	\$574.00	\$750.00	\$729.00	\$864.00	*	*	*	*
Newman (ZNE) (6 July 2017)	1021	\$624.00	\$750.00 - 1042.01	\$1,309.99	\$1,098.51	\$1,470.00	*	*	*	*
Broome (BME) (7 July 2017)	1676	*	\$1,064.00	\$1,360.00	\$1,092.00	\$1,326.00	*	*	*	*
Kununurra (KNX)	2213	*	\$1,664.00	\$1,697.99	\$1322.00 - \$1765.00	\$1629.00 - \$2769.00	*	*	*	*



## WA AIRPORTS SERVICED BY SKIPPERS AVIATION – GASCOYNE/MURCHISON

Travel Destination from Perth (and return)	One-Way Distance	Return Distance				Skippers Aviation	Passenger Fare Per Km
	Kms	Kms					
Mount Magnet - 5 July 2017	579	1158				\$652.00	\$0.56
Carnarvon - 6 July 2017	910	1820				\$968.00	\$0.53
Meekatharra - 7 July 2017	649	1298				\$731.00	\$0.56
Monkey Mia - 7 July 2017	715	1430				\$835.00	\$0.58

## WA AIRPORTS SERVICED BY REX – SOUTH COAST

TRAVEL DESTINATION FROM PERTH (AND RETURN)	One-Way Distance	Return Distance	Rex	Rex	Rex	Rex	Passenger Fare Range Per Km
	Kms	Kms	Net	Saver	Biz	Flex	
Esperance (EPR) - 13 July 2017	602	1204	\$339.22	\$405.22	\$658.22	\$719.82	\$0.28-\$0.59
Albany (ALH) - 7 July 2017	392	784	*	\$391.07	\$589.07	\$655.07	\$0.49-\$0.83

## WA REGIONAL AIRPORTS SRVICED BY VIRGIN / VARA

TRAVEL DESTINATION FROM PERTH ( <b>AND RETURN</b> ) * Route not available	One-Way Distance	Return Distance	Virgin	Virgin	Virgin	Passenger Fare Range Per Km
	Kms	Kms	Getaway	Elevate	Freedom	
Exmouth (Learmonth LEA) - 6 July 2017	1096	2192	*	*	*	*
Onslow (ONS) - 4 July 2017	1150	2300	*	\$598.00	\$1,198.01	\$0.26-\$0.52
Geraldton (GET) - 6 July 2017	371	742	*	\$378.00	\$558.01	<b>\$0.51-\$0.75</b>
Esperance (EPR) - 13 July 2017	602	1204	*	*	*	*
Karratha (KTA) - 6 July 2017	1250	2500	\$914.00	\$974.00	\$1,350.01	\$0.36-\$0.54
Albany (ALH) - 7 July 2017	392	784	*	*	*	*
Port Hedland (PHE) - 6 July 2017	1648	3296	\$844.00	\$913.00	\$1,328.00	\$0.25-\$0.40
Kalgoorlie (KGI) - 7 July 2017	538	1076	*	\$574.00	\$750.00	<b>\$0.53-\$0.69</b>
Newman (ZNE) (6 July 2017)	1021	2042	\$624.00	\$750.00 - 1042.01	\$1,309.99	\$0.30-\$0.64
Broome (BME) (7 July 2017)	1676	3352	*	\$1,064.00	\$1,360.00	\$0.31-\$0.40
Kununurra (KNX)	2213	4426	*	\$1,664.00	\$1,697.99	\$0.37-\$0.38

## WA REGIONAL AIRPORTS SERVICED BY QANTAS / QANTASLINK

TRAVEL DESTINATION FROM PERTH ( <b>AND RETURN</b> ) * Route not available	One-Way Distance	Return Distance	Qantas	Qantas		Passenger Fare Range Per Km
	Kms	Kms	Red e-Deal	Flex		
Exmouth (Learmonth LEA) - 6 July 2017	1096	2192	\$818.00	\$1,018.00		\$0.37-\$0.46
Onslow (ONS) - 4 July 2017	1150	2300	*	*		*
Geraldton (GET) - 6 July 2017	371	742	\$449.00	\$612.00		<b>\$0.60-\$0.82</b>
Esperance (EPR) - 13 July 2017	602	1204	*	*		*
Karratha (KTA) - 6 July 2017	1250	2500	\$1,027.00	\$1,454.00		\$0.41-\$0.58
Albany (ALH) - 7 July 2017	392	784	*	*		*
Port Hedland (PHE) - 6 July 2017	1648	3296	\$882.00	\$1,424.00		\$0.26-\$0.43
Kalgoorlie (KGI) - 7 July 2017	538	1076	\$729.00	\$864.00		<b>\$0.67-\$0.80</b>
Newman (ZNE) (6 July 2017)	1021	2042	\$1,098.51	\$1,470.00		\$0.53-\$0.72
Broome (BME) (7 July 2017)	1676	3352	\$1,092.00	\$1,326.00		\$0.32-\$0.39
Kununurra (KNX)	2213	4426	\$1322.00 - \$1765.00	\$1629.00 - \$2769.00		\$0.29-\$0.62

<b>BITRE: Annual PASSENGER movements — Y/E June 2015 &amp; June 2016</b>				
<b>National Rank</b>	<b>City-Pair Route</b>	<b>YE Jun 2015</b>	<b>YE Jun 2016</b>	<b>% Change</b>
26	Karratha - Perth	651 601	551 168	-15.4
33	Perth - Port Hedland	442 662	357 993	-19.1
35	Newman - Perth	348 417	319 450	-8.3
37	Broome - Perth	297 956	303 872	+2.0
42	Kalgoorlie - Perth	219 618	225 886	+2.9
	Paraburdoo-Perth	179 742	163 207	-9.2
65	Geraldton - Perth	121 781	117 709	-3.3
	Learmonth-Perth	85 620	86 050	+0.5
	Kununurra-Perth	77 407	74 334	-4.0
	Albany-Perth	56 950	53 201	-6.6
	Esperance-Perth	52,696	50,411	-4.3
	<b>Total national domestic network</b>	<b>57 232 928</b>	<b>58 406 349</b>	<b>+2.1</b>
<b>BITRE: Annual AIRCRAFT movements — Y/E June 2015 &amp; June 2016</b>				
	<b>City-Pair Route</b>	<b>YE Jun 2015</b>	<b>YE Jun 2016</b>	<b>% Change</b>
	Karratha - Perth	7 789	7 515	-3.5
	Perth - Port Hedland	4 982	4 635	-7.0
	Broome - Perth	3 139	3 359	+7.0
	Kalgoorlie - Perth	3 338	3 398	+1.8
	Paraburdoo-Perth	2 864	2 668	-6.8
	Geraldton – Perth**	3 391	2 841	-16.2
	Learmonth	1 319	1 243	-5.8
	Kununurra	2 192	2 170	-1.0
	Albany**	1 764	1 817	+3.0
	Esperance**	1 588	1 539	-3.1
	<b>Total national domestic network</b>	<b>633 147</b>	<b>637 005</b>	<b>+0.6</b>

[\*\*Note: Change at Geraldton from Virgin F50s and QantasLink Q400 turboprop types to F100 Jets by both airlines. Changes at Esperance and Albany with withdrawal of Virgin F50s, replaced by REX smaller aircraft types <20T MTOW)

## **BASELINE DATA: SCALE OF REGIONAL AIRPORT OPERATIONS BY PASSENGER NUMBERS AND AIRCRAFT MOVEMENTS**

**BITRE: WA Regional Airports – Passenger Movement Changes 2014 to 2015**

Reflecting the earlier transition of Pilbara mining from Development to Production, and wider economic downturn:

Airport	Passenger Movements Y/E Dec 2014 (000's)	Passenger Movements Y/E Dec 2015 (000's)	Percentage Change 2014 to 2015
Karratha	710.4	607.6	-14.5%
Port Hedland	521.0	418.9	-19.6%
Broome	400.9	389.9	-2.7%
Newman	370.9	331.2	-10.7%
Kalgoorlie	231.8	228.9	-1.2%
Paraburdoo	193.3	167.1	-13.5%
Geraldton	130.5	119.2	-8.7%
Kununurra	112.1	103.1	-8.0%
Learmonth	88.2	85.5	-3.1%

**OBSERVATIONS**

- Geraldton has a resident population of 40,000. Its RPT passenger profile is dominated by Business & Government, Visiting Friends & Family, and travellers accessing health, education and professional services. Geraldton Airport has no significant inbound FIFO traffic. Tourism/Recreation travellers represent a small minority of air travellers – but growing.
- Karratha (resident population 27,000), Port Hedland (residents 16,000), Newman (residents 7,000), Kalgoorlie-Boulder (residents 33,000) and Paraburdoo are all Resources Sector FIFO destinations. Significant decreases in FIFO passenger numbers resulted from the transition to new/expanded Mine production, and the decline in iron ore demand and prices.
- Broome (residents 15,000, but with average population growing to 45,000 during the dry/non-cyclone season) is primarily a Tourism destination.
- Learmonth was partly deregulated, with QantasLink entering the market against Virgin. Virgin subsequently withdrew.