

GIIA Webinar
Airports - The Runway to Recovery

Webinar summary

10th June 2020

GIIA

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Covering letter

Aviation Webinar – The Runway to recovery

Dear GIIA Members,

We were delighted to have welcomed so many participants to our Airport webinar. Our aim was to examine the short and long term outlook for the sector in the wake of the Covid-19 pandemic, investigating the implications for airport investors.

Airports are a significant asset class within the GIIA community. According to our records, 22 of GIIA investors have interests over 100 individual airports over more than 14 countries and circa 1 billion passengers/year in total.

We aimed to cover three broad themes:

- Latest sector outlook, and most recent views in relation to demand recovery
- Implications for the airport investment programmes
- Long term implications for the sector

The webinar had three contributors as follows:

- Adria Canals-Macia, head of Transport in Arup BIA and 24 years of experience in Airports
- Ed Moser, a partner in the Global Infrastructure Group at Allen & Overy law firm with extensive experience in the aviation sector
- Michael Stanton-Geddes, head of Aviation Economics & Competition at ACI Europe

This presentation has been complied by Arup and covers the main issues discussed in the webinar with the aim to provide a summary of the key themes for the wider GIIA community.

The discussion was remarkably fruitful and we finished with the clear idea that the aviation sector will recover and will also emerge with a different agenda to fulfil and that will require proactive airport management to deliver.

Thanks for your interest in the webinar. Attendance was impressive and we hope to continue to attract the interest of our members in future webinars.

Yours sincerely,

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Webinar Summary

Nick Oxford/Reuters

Victorville, California on March 28.
Source: AirTeamImages

NPAS/BBC /Bournemouth airport

Question 1 – The demand recovery

What is the short and medium term outlook for the sector in terms of passenger throughput ?

The current context is more difficult than it has ever been.

In the short term the context is being influenced by government measures (border restrictions and medical policies). In Europe, there is no coordination of measures and it is harming demand.

A positive development has been that Brussels has been seeking coordination between different EU countries and from 15th of June, travel is set to resume between Schengen countries. ACI Europe is pushing for these actions to be rolled out beyond the Schengen area and beyond Europe for those countries with similar epidemiological conditions.

Short term forecasting is evidently challenging for airlines. They have been showing the full schedule for 2020 whilst cancelling flights two weeks in advance. This also makes airport planning more difficult, as airports tend to rely on this information (which is available in the OAG database).

Long term predictions from ACI, IATA, rating agencies suggest that passenger numbers are likely to recover to 2019 levels around the second half of 2023 or even 2024.

ACI Europe have been publishing a number of working papers to guide the industry (https://www.aci-europe.org/industry-topics/covid-19.html). The most recent paper focused on the recuperation of the aviation supply-chain.

GDP is the oxygen of transport growth, and we are expecting that governments will put in place measures to recover the economy.

In the short term airlines are planning schedules for July which represent 20-30% of the capacity they used to have in 2019, reaching 50%-60% in August. The focus will be to maintain profitable destinations and reduce some frequencies (for instance Easyjet is planning to reach 50% of the routes in July and 75% of the routes in August). Lufthansa and Air France are restructuring and both will have to reduce slots in their main hubs. Air France has been specifically asked to release routes in competition with High-Speed Trains.

It is important to understand how relevant each airports is to the airline network, since not all aircraft will be utilised in the next 2 years. Besides, airlines will be looking for airport charge discounts to make routes more attractive, as IATA claims they may be more expensive to operate with higher turnaround times.

From the airport business perspective, 3 phases of recovery are foreseen. The first one (ongoing) focuses on managing operating costs and liquidity to best survive this period, as well as on seeking covenant relief from their financing arrangements (hibernation phase almost until the end of the year, depending on the summer months).

The next phase of the recovery (the next 12 to 36 months) will continue to focus on liquidity and government support where available and will see a many airports take detailed steps to reappraise medium to long term business plans. In this period we anticipate engagement with regulators / grantors (e.g. through regulatory reviews such as H7 for Heathrow or G7 for Gatwick or potential re-negotiation of concession agreements) to seek to appropriately allocate risk associated with those revised business plans.

The final phase is likely to be one of implementation and moving away from government support. This transition will require may airports to revisit their capital structures as they seek to settle on the right framework to take airports forward.

The speed of recovery will be different depending on the specific airport, catchment area and exposure of airline structural changes.

From a legal perspective it will be also interesting to look at the impact of Brexit and the future relationship laid out in new air service agreements entered into by the UK and whether a deliberalisation in international trade may have an adverse effect on the Open Skies agreement between the EU and the USA.

Most successful airports will need to maximise commercial revenue to compensate for the airport charge shortage. These initial sources will probably not come from retail but initially from car parking, rents, advertising or other terminal services (like fast-track or lounges). In the short term there may be benefits from food & beverage offers, since some airlines may not offer any service on board (EasyJet has announced it won't offer any service on board at the moment).

Question 2 – The investment challenge

What do all these challenges mean for the investment programme for airports? What are the new priorities?

Investment is changing. The focus of this change is in two areas: technology and efficiency. Capacity is almost disappeared at the moment. This is surprising compared to the summer of 2018 when everyone was talking about the capacity crunch. Some airports have already folded expansion projects, but from an airport systems perspective, we still see some airports working on capacity improvements.

Technology refers to improving capacity throughput and touchless solutions. The analysis of big data is allowing airports to increase capacity without extending their existing facilities. There are examples in Dubai of how security queues improved over 30% just by understanding why passengers were stopped when passing the security arch. In other cases, we have seen apron stands in congested airports like Heathrow able to generate higher apron utilisation after analysing apron demand data in detail. Overall, capacity work is about extracting more capacity from the existing infrastructure.

The second interesting point about technology is how passenger processing can be made touchless, the importance of which is has increased due to Covid. We are seeing an additional push for biometrics and innovation is possible around digital identity, like the application set up by the UK government (https://www.gov.uk/government/publications/introducing-govuk-verify/introducing-govuk-verify). We can see the possibility to use that type of application in airports. In fact, Arup has seen how the design for the new airport Navi Mumbai is already planning their airport systems to facilitate online passport verification. This is only the beginning.

The most common source of efficiency continues to come from energy, initially through energy efficiency measures in airport facilities and more recently with the adoption of renewables for generating energy locally. This is most efficient when electricity costs are high and the airports are able to self-consume.

Maintenance has also been prioritized for those projects that are difficult to do when airports are operating like, for example, runway resurfacing. Initially only those airports that have been programming works for this year will really benefit from savings which could be as high as 30-50% of the cost of doing runway overlay at night.

In the short term there are special investments/operational actions related to signage, better cleaning and passenger temperature checking that are done to improve passenger comfort. Special investments related to social distancing would require a change in the airport business model, as some of the actions may be detrimental to EBITDA . For instance, it is hard to see how security can change after Covid, the same way it changed after September 11, because it will be a very dramatic change for the airport and reduce significantly its current capacity.

If we look at financing for these investments, airports will need to find the right balance between investment and preserving liquidity, particularly those that may have had to re-purpose existing capex lines to meet short term working capital needs. Each airport will need to find the correct answer, but it is not simple because the return on investment may take a number of years and raising financing may be challenging. As a result airports may need to explore new sources of credit or, ultimately, may require equity to meet some of these costs. As noted above, this is likely to drive a wider reassessment of capital structures.

Finally, regulatory bodies and authorities may have to look at investment programmes in a pragmatic way. Typically ACI is of the view that authorities have been basically trying to keep airport charges to a minimum for airlines, but now they may have to look at the airport system implications. This means that the risk allocation between the stakeholders in airports may have to change.

Question 3 – The longer term implications

How do investors ensure airports remain an attractive asset class? Where does the Net Zero debate fits in after Covid-19?

Covid is probably going to delay decarbonisation plans at an airport level, but from a policy perspective, it seems unlikely that regulators and governments will change their agenda in relation to Net Zero. It is worth remembering, for example, that it was only a few months ago that the Airports National Policy Statement, which effectively approved the development of a third runway at Heathrow, was ruled unlawful by the Court of Appeal due to a failure by the UK government to take its climate change commitments under the Paris Agreement into account.

One challenge for governments and regulators, however, will be how to deliver the Net Zero agenda whilst keeping the air transport sector sustainable, given the support provided to the airline industry at the moment. It will be interesting to see where budgets will be cut by aircraft manufacturers and airlines and whether low oil prices may prove to be a disincentive to decarbonisation for an industry trying to get back on its feet. As a result, governments may seek to align their support packages to their wider policy objectives.

At an investor level, sustainability and ESG are becoming increasingly important parts of the investment criteria for private investors. The need for sustainable and resilient portfolios will play a key role in driving the decarbonisation agenda, the effects of which will be seen across all infrastructure sectors, especially for transport assets.

From ACI Europe's perspective, the industry needs to continue to remain credible and there is no reason to reduce Net Zero commitments. For airports which are local actors, assets can't be moved to look for a place with better tax advantages, so airport CEOs are committed to Net Zero and Green agenda.

Governments have increased their debt to record levels and it is unlikely that they will be willing to finance airport investments. We see that the private sector will continue to play a role to finance initiatives.

In the future we see that in order to remain relevant to Responsible Investors, it is important that airports start to consider the sustainable goals defined by the UN (the SDGs).

Questions from the audience

Is the historic link between RAB, capex and allowable return broken in the short term?

ACI Europe just published a paper “rethinking airport regulation” targeted towards governments and regulators (https://www.aci-europe.org/industry-topics/covid-19.html) which provides a good answer to this question. IATA understood that RAB was a useful model under normal circumstances, however they are now not accepting the consequences of applying it in an environment of low traffic, where traffic charges would need to increase significantly. Airlines consider flexibility to be important in the short term, but still think single-till regulation is the best regulatory model for them.

RAB may be under pressure, but the real problem is in when it is applied unnecessarily, when the market can take care of the relationship between the airline and the airports.

Which airports emerge stronger, those than have single-till or non-regulated airports?

This is difficult to answer. The first challenge for airports would concern their ability to respond through pricing to stimulate the market. Non-regulated airports can compete to attract the initial aircraft that will serve the reduced demand through discounts, a short term advantage that could be turned into a long term advantage. Single-till airports may be disadvantaged, unless they can offer discounts to the price cap, so the message for regulators and governments is that airports should be given more discretion to apply airport charges to stimulate traffic.

The challenge for regulators is to provide consumer protection in which case the expected higher airport charges may not be the right solution.

It should be noted that regulation works when the airport can exercise market power besides, it should be noted that in some cases regulation sets up a maximum charge. In the past some airports may not have had the ability to charge the maximum amount (like is the case after financial crisis), and we expect this to continue in the short term after Covid.

Is remote working and video conferencing is going to impact demand recovery?

This is a hot debate at the moment and it does not only affect air transport. All mobility is changing. We have seen that rail traffic from commuters has almost disappeared. We see in our own companies how people have adapted to work remotely and using video conferencing.

Businesses are increasingly focused on ESG and we expect people will be more responsible in how they travel for business after Covid-19. However, it could also be argued that whilst Videoconferencing was well accepted in the early stages of Covid-19, we are seeing also some sort of “Zoom fatigue”. So perhaps there is a possibility that we return back to the previous normal.

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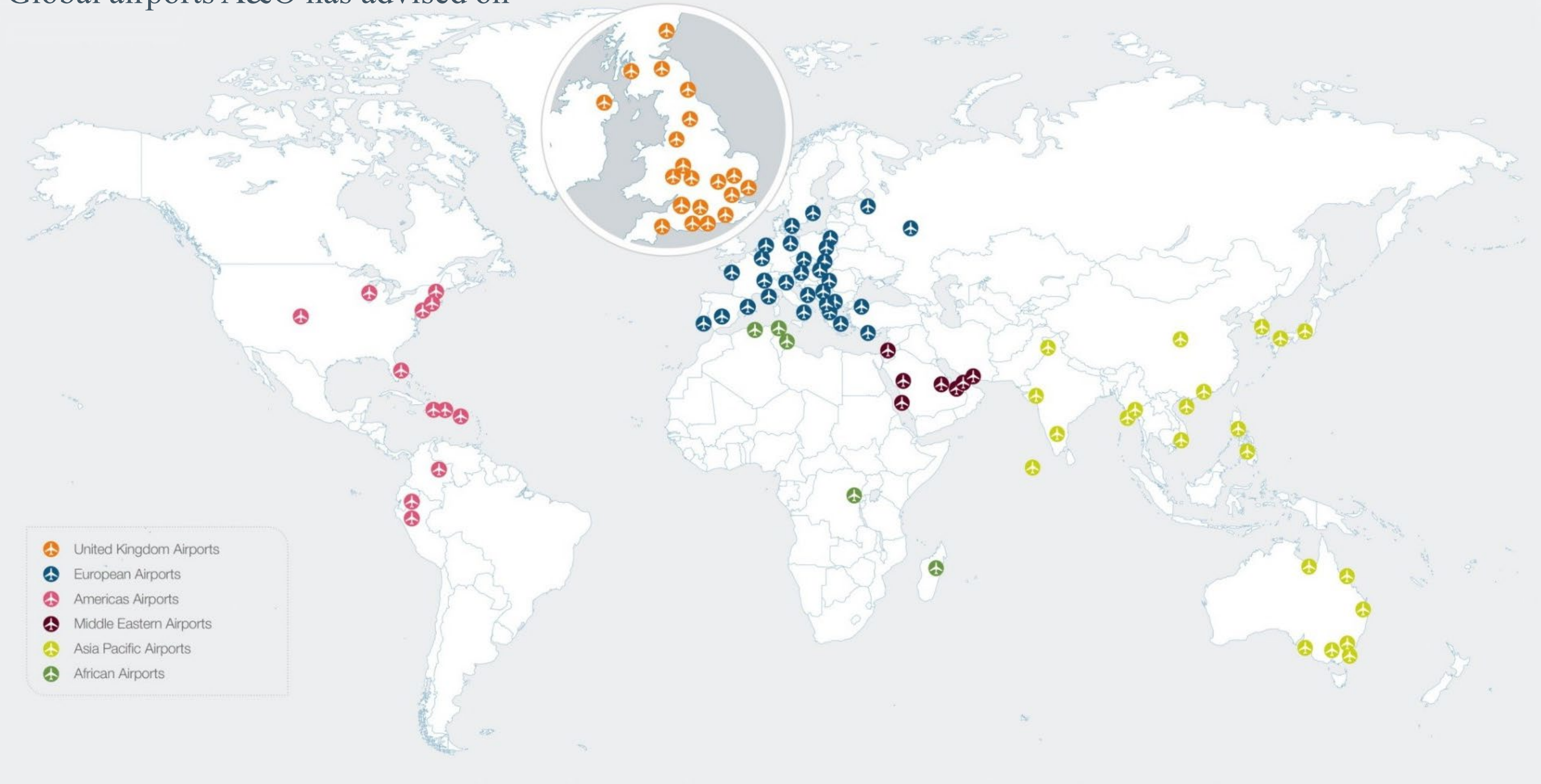

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