COUNTY OF SAN LUIS OBISPO
BOARD OF SUPERVISORS
AGENDA ITEM TRANSMITTAL

(1) DEPARTMENT	(2) MEETING DATE	(3) CONTACT/PHONE
Airports	11/6/2018	Kevin Bumen, Director 805-781-5205

(4) SUBJECT

Request to approve a Minimum Revenue Guarantee (MRG) Program to support solicitation of additional air service at San Luis Obispo County Regional Airport in the amount of $1,000,000, funded by the Tax Reduction Reserve Fund in FY 2018-19, and to be considered for annual renewal through the County budget process and administered by Department of Airports, at the San Luis Obispo County Regional Airport, by 4/5 vote. District 3.

(5) RECOMMENDED ACTION

It is recommended the Board approve:

1) request to approve Minimum Revenue Guarantee (MRG) Program as outlined here-in, to be considered for renewal annually through the County budget process and administered by Department of Airports;
2) request to create a new designation in the Tax Reduction Reserve Fund titled “Des FB-MRG Program”
3) request to use the $206,692 currently appropriated in FC 268 - Tax Reduction Reserve Fund as a funding source to partially fund the $1,000,000 needed in the FB-MRG Program Designation;
4) request to reduce the FB-Airport Terminal Designation by $793,308 and increase the FB-MRG Program Designation by the same amount to bring the total to $1,000,000 in the FB-MRG Program Designation;
5) request to authorize the Auditor-Controller Treasurer-Tax Collector (ACTTC) to use the FB-MRG Program Designation as a funding source to appropriate funds for the MRG Program as required in the future, in compliance with the terms of the MRG Program; and
6) request to authorize any future budget adjustment required to administer the MRG Program up to a maximum of $1,000,000 within FY 2018-19 as outlined here-in, without returning to the Board for specific approval, at the San Luis Obispo County Regional Airport, by 4/5 vote. District 3.

(6) FUNDING SOURCE(S)	(7) CURRENT YEAR FINANCIAL IMPACT	(8) ANNUAL FINANCIAL IMPACT	(9) BUDGETED?
Tax Reduction Reserve Fund	Up to $1 million	$0.00	No

(10) AGENDA PLACEMENT

{X} Consent { } Presentation { } Hearing (Time Est. ________) { } Board Business (Time Est.______)

(11) EXECUTED DOCUMENTS

{ } Resolutions { } Contracts { } Ordinances { X} N/A

(12) OUTLINE AGREEMENT REQUISITION NUMBER (OAR)	(13) BUDGET ADJUSTMENT REQUIRED?
N/A	BAR ID Number: N/A {X} 4/5 Vote Required { } N/A

(14) LOCATION MAP	(15) BUSINESS IMPACT STATEMENT?	(16) AGENDA ITEM HISTORY
N/A	No	{ } N/A Date: 11/5/2013

(17) ADMINISTRATIVE OFFICE REVIEW	David E. Grim
(18) SUPERVISOR DISTRICT(S)	District 3

COUNTY OF SAN LUIS OBISPO

TO: Board of Supervisors

FROM: Airports / Kevin Bumen, Director

805-781-5205

DATE: 11/6/2018

SUBJECT: Request to approve a Minimum Revenue Guarantee (MRG) Program to support solicitation of additional air service at San Luis Obispo County Regional Airport in the amount of $1,000,000, funded by the Tax Reduction Reserve Fund in FY 2018-19, and to be considered for annual renewal through the County budget process and administered by Department of Airports, at the San Luis Obispo County Regional Airport, by 4/5 vote. District 3.

RECOMMENDATION

It is recommended the Board approve:

1) request to approve Minimum Revenue Guarantee (MRG) Program as outlined here-in, to be considered for renewal annually through the County budget process and administered by Department of Airports;
2) request to create a new designation in the Tax Reduction Reserve Fund titled "Des FB-MRG Program"
3) request to use the $206,692 currently appropriated in FC 268 as a funding source to partially fund the $1M needed in Des FB-MRG Program;
4) request to reduce Des FB-Airport Terminal by $793,308 and increase Des FB-MRG Program by the same amount to bring the total to $1M in Des FB-MRG Program;
5) request to authorize the ACTTC to use Des FB-MRG Program as a funding source to appropriate funds for the MRG Program as required in the future, in compliance with the terms of the MRG Program; and
6) request to authorize any future BAR required to administer MRG Program as outlined here-in, without returning to the Board for specific approval, at the San Luis Obispo County Regional Airport, by 4/5 vote. District 3.

DISCUSSION

In November 2013, the Board of Supervisors approved an Airline Revenue Guarantee Program ("Program") for San Luis Obispo County Regional Airport (SBP). Funding for the Program was comprised of:

1. a United States Department of Transportation (US DOT) Small Community Air Service Development (SCASD) Grant in the amount of $500,000, originally issued in February 2010 to expire December 31, 2013, and subsequently amended on an annual basis;

2. $212,500 US DOT SCASD Grant matching funds provided by County of San Luis Obispo Fund Center (FC) 268 Tax Reduction Reserve Fund;
3. $37,500 in locally donated funds; and
4. Over $1M unsecured pledges from San Luis Obispo's business community designated for pre-purchased tickets.

In April 2017, SBP and Alaska Airlines entered into an Air Service Agreement that incorporated the Program with other incentives, including forgiveness of fuel flow fees, and landing fees associated with new daily air service from SBP to Seattle (SEA). The eligible service period extended through April 2018, and the maximum revenue guarantee amount payable per the Air Service Agreement totaled $712,000. In collaboration with the Airport, Visit SLO Cal invested approximately $100,000 in promoting this new route, contributing to its overall success. No funds were distributed to Alaska Airlines in fulfillment of the revenue guarantee under the Air Service Agreement, based on the success of the route, and less than $20,000 will be drawn against the SCASD grant for eligible expenses incurred by SBP. Because the funding period has effectively ended with the termination of Alaska's revenue guarantee, and per SCASD Grant specifications, only one destination can be funded with the grant, SBP has effectively lost access to the $500,000 grant through the US DOT SCASD, which could be used towards revenue guarantees and is therefore proposing to reallocate the remaining matching funds in the amount of $206,692 currently appropriated as matching funds to the SCASD Grant to the new FB-MRG Program Designation described here-in. Termination of the SCASD Grant effectively terminates SBP's current revenue guarantee program, and without replacing with a new program significantly limits the Airport's ability to negotiate new air service in the modern environment.

Air service recruitment has changed substantially over the last decade. Now, virtually all airports in the United States offer airlines some type of incentive program to encourage new service. The most common airport-provided incentives are fee waivers, marketing and advertising cash and credits to help an airline pay for its ground handling costs.

Incentives vs. Subsidies: The Federal Aviation Administration's (FAA's) ***Revenue Use Policy*** maintains a distinction between subsidizing air carriers and the waiving of fees as incentives; summarily the Revenue Use Policy prohibits "subsidizing." An ***"incentive"*** is any fee reduction, fee waiver or use of airport revenue for acceptable promotional costs, where the purpose is to encourage an air carrier to increase service at the airport. A ***"subsidy"*** is direct payment of airport revenue to a carrier or to any provider of goods or services to that carrier, in exchange for additional service by the carrier. *MRG's are a classic example of a subsidy and are designed to reduce an airline's risk of losing money for the start-up period of new service.* An airline typically develops a revenue target per flight, and the MRG fund is invoiced when actual revenue is below target revenue. Most MRGs are agreements between outside community funding organizations, and the air carrier, not involving the airport; however, there are exceptions.

FAA strictly prohibits airport sponsors from using airport revenue subject to the *Revenue Use Policy* for air carrier subsidies under any circumstances; however, it is possible that separate tax revenue not subject to the *Revenue Use Policy* can be used for direct air carrier subsidies, where generation of the funds has no direct relationship to the airport. In these cases where the revenue is not subject to the *Revenue Use Policy*, the airport sponsor must make the subsidy available to all similarly situated air carriers providing the same level of new service. This revenue not subject to the *Revenue Use Policy* MUST be maintained in a separate account and not comingled with other airport funds.

The best long-term strategy for an airport to grow and maintain air service is to offer airlines an exceptionally low cost of operation, since they often try to stimulate new passengers by offering low fares. Airlines weigh the risk of low fares against airport incentives, and MRG's. *Typically, only airports that can participate in the up-front risk of a new route and who are willing to help offset startup costs are being considered for new service.*

In today's extremely competitive market for new air service, and in consideration of airline risk averseness, SBP is attempting to position itself to assertively and confidently pursue additional air service and new destinations through implementation of the below described Minimum Revenue Guarantee (MRG) Program, and other incentives.

San Luis Obispo County Regional Airport Minimum Revenue Guarantee (MRG) Program

1. Routes Eligible: New, non-stop flights to designated targeted markets, on a first-come-first-served basis
2. Targeted Markets:
   - -Dallas/Ft. Worth, Texas
   - -Houston, Texas
   - -Portland, Oregon
   - -Sacramento, California
   - -Salt Lake City, Utah
   - -San Diego, California
   - -Chicago, Illinois
   - -Las Vegas, Nevada
3. Duration: Up to 24 months from the start date of new service, as defined by Air Service Agreement(s) between airline(s) and SBP
4. Maximum funding: $1,000,000 per year, to be considered for renewal on an annual basis per County budget cycle
   a. Multiple agreements eligible to run concurrently, not to exceed the maximum funding amount for the entire MRG program
5. Terms: to be determined in Air Service Agreement(s)

OTHER AGENCY INVOLVEMENT/IMPACT

County Counsel has reviewed the Minimum Revenue Guarantee Program for form and legal effect.

FINANCIAL CONSIDERATIONS

Please see Clerk Filed Air Service Incentive Analysis (Volaire Aviation, Inc.) for a comprehensive cost/benefit analysis of new network carrier regional air service, and domestic, less-than-daily service.

New daily network carrier regional jet service is forecast to generate more than 21,000 total annual enplanements, and domestic less-than-daily service is forecast to generate almost 17,000 annual enplanements. Each passenger currently generates approximately $11.80 in revenue to the Airport, as reported in the 2017 FAA Annual Report. Based on these numbers, new daily network carrier regional jet service is forecast to produce just under $250,000 in Airport revenue per year, and the less-than-daily service utilizing larger planes is forecast to produce almost $200,000 in Airport revenue per year. While the revenues will potentially be offset to a lesser degree by various incentives offered by the Airport as outlined in the new San Luis Obispo County Regional Airport Air Service Incentive Program, the routes produce a net-positive revenue stream. In addition, any incentive offered is strictly limited to a maximum of two years, after which time the Airport will realize the entire revenue stream produced by any additional flight.

In addition to Airport revenue generated directly by new air service, any new air service will have significant positive economic impact to San Luis Obispo, and San Luis Obispo County as a whole. While Department of Airports cannot yet provide meaningful projections as to said impact, we have retained industry expert Volaire Aviation, Inc. to perform a comprehensive economic impact study designed to measure the direct, indirect and induced economic impacts of the Airport to the region, in addition to projecting impacts specific to one additional flight. We anticipate completion of the study in the first quarter of calendar year 2019. The results and projections derived from the study will be provided to your Board, once available.

Economic impacts of an airport measure the importance of aviation as an industry in terms of the employment it provides and the goods and services it consumes. Economic impacts are the beneficial results that help to generate and sustain public support for airports. ***Direct Impacts*** are consequences of economic activities carried out at an airport by various tenants and individuals having direct involvement in aviation (airlines, airport management, fixed base operators, etc.). Employing labor, purchasing locally produced goods and services, paying taxes and contracting for capital improvements are examples of activities at an airport that generate direct impacts. These activities would not have occurred in the absence of the airport. ***Indirect Impacts*** derive primarily from off-site activities that are partially attributable to an airport, including expenditures made by passengers traveling through the airport. ***Induced Impacts*** are the multiplier effects of the direct and indirect economic impacts produced by an airport and are represented by employment and expenditures created by successive rounds of local spending and hiring.

Funding Source: Two sources will be used to fund the $1M Minimum Revenue Guarantee (MRG) Program. The first funding source will be provided by canceling an appropriation of $206,692 that is no longer needed in FC 268 - Tax Reduction Reserve Fund. As previously discussed, this amount is currently appropriated as matching funds for the SCASD Grant and is now available to increase the Designation FB-Minimum Revenue Guarantee (MRG) in the Tax Reduction Reserve Fund. The remaining balance of $793,308 will be provided by reducing the Designation FB-Airport Terminal in the Tax Reduction Reserve Fund and increasing the new Designation FB-MRG.

The Designation FB-Airport Terminal has a current balance of $8,512,585. It was originally established for $11,687,490 in August 2015 to provide assurance to the lender that the County had committed sufficient funds to cover the New Airport Terminal project's second year funding plus contingencies. In November 2016, additional funding for the project became available so the County was able to release $6,779,405 from the designation, leaving a balance of $4,908,085. Later, in December 2016 the designation was increased $3,604,500 for additional non-reimbursed costs that needed to be financed by the County.

The Department of Airports is currently in the process of amending three (3) grants used to fund a portion of the New Terminal project. The projected federal share of AIP eligible change order (CO) funding totals $3.3 M dollars. It is anticipated that the FAA will approve the Terminal Project change orders submitted, which in turn will reduce the project's need for funding provided by the Tax Reduction Reserve Fund. Although the additional change orders have not been approved, the Airport believes the likelihood is very high that the FAA will approve at least $793,308 and therefore is requesting that the Designation FB-Airport Terminal be the funding source for a portion of the guarantee program.

RESULTS

Approval of this Minimum Revenue Guarantee Program will provide Department of Airports with a program that incorporates current Federal guidelines and provides for industry best practices in pursuit of additional air service at San Luis Obispo County Regional Airport. In addition, it will enable the Department to more effectively collaborate with Visit SLO CAL and complement their marketing program, providing the Department with a full range of air service development tools necessary to assertively and confidently pursue additional air service and new destinations for the residents of our County. As air service increases, residents and businesses of the County benefit, contributing to a more livable and prosperous community.

ATTACHMENTS

1. Minimum Revenue Guarantee (MRG) Policy
2. Clerk Filed: New Air Service Incentive Analysis