City of Richmond
Councillor's Office

Copied & distributed to all.
Date: FRI. NOV. 12/04
Initials: AJ

Memorandum

To: **Mayor and Councillors** **Date:** November 12, 2004
From: **Councillor Rob Howard**
Re: **YVR Resolutions on Open Skies, Fifth Freedom Rights and Open Skies**

Please see the attached Resolutions and Backgrounders. I would like to discuss this at our next GP meeting.

My purpose is to build grass root support and to recognize the importance of the airport to the economy of Richmond, the Region, the Province and the Country. As well, to recognize that changes to Canada's International Air Policy are needed for Canada to maintain pace with the rest of the world. With respect to rent, the purpose of the Resolution is to recognize the inequity of rents charged when compared to other airports in the country.

While these issues are national and international in nature, they also have a direct impact on the future of the airport, and as a result the economic prosperity and job growth for Richmond.

Thank you for your consideration,

RHoward

Rob Howard

1354217

RICHMOND
Island City, by Nature

Draft Resolution
Re: Federal Rent and Airport Competitiveness

WHEREAS the Vancouver International Airport is an economic generator and facilitates job creation province wide with the most recent economic impact study showing that the airport is responsible for a total economic output of $5.183 billion and 54,182 person year of employment;

AND WHEREAS the Vancouver International Airport Authority has paid over $660 million in rent to the federal government for a facility which had a historical cost of $255 million;

AND WHEREAS and the return from Vancouver International Airport should be provincial and national economic growth not rent; and

THEREFORE BE IT RESOLVED that the City Of Richmond call upon the federal government to adopt a new rent policy that is fair, equitable, transparent and sustainable and includes: a 50% reduction of total rent throughout the airport system; the elimination of rent entirely for all but the eight largest airports, and tying future increases directly and proportionately to changes in passenger and freight traffic;

AND BE IT FURTHER RESOLVED that this resolution be conveyed to the UBCM, the LMMA, the Federation of Canadian Municipalities, requesting there support, and the provincial and federal governments.

Vancouver International Airport Authority
Briefing Note

Federal Rent

- The Vancouver International Airport Authority (the "Authority") pays too much rent to the federal government and would like to see a revised rent policy that is fair, transparent and sustainable.

- Vancouver is willing to pay a reasonable, equitable rent. However, a reduction in federal rent is important to the sustainability of Canada's aviation industry. Rent is the single biggest cost of operating Vancouver International Airport and most other airports that pay federal rent. Rent consumes over 25% of Vancouver's total revenues.

- In his 2000 report on the divested airports, the Auditor General stated: "Transport Canada cannot demonstrate how the details for the transferred airports are equitable, uniform, consistent and fair with one another as the government directed." Other than Montreal, which pays minimal rent, Vancouver is the only airport without a cap on rent.

- Vancouver was one of the first airports to be transferred. Subsequent airports were transferred under more favorable lease arrangements, including a rent cap. As a result, Vancouver faces an ever increasing rent payment and pays well in excess of the national average rent per passenger. See chart on page 2.

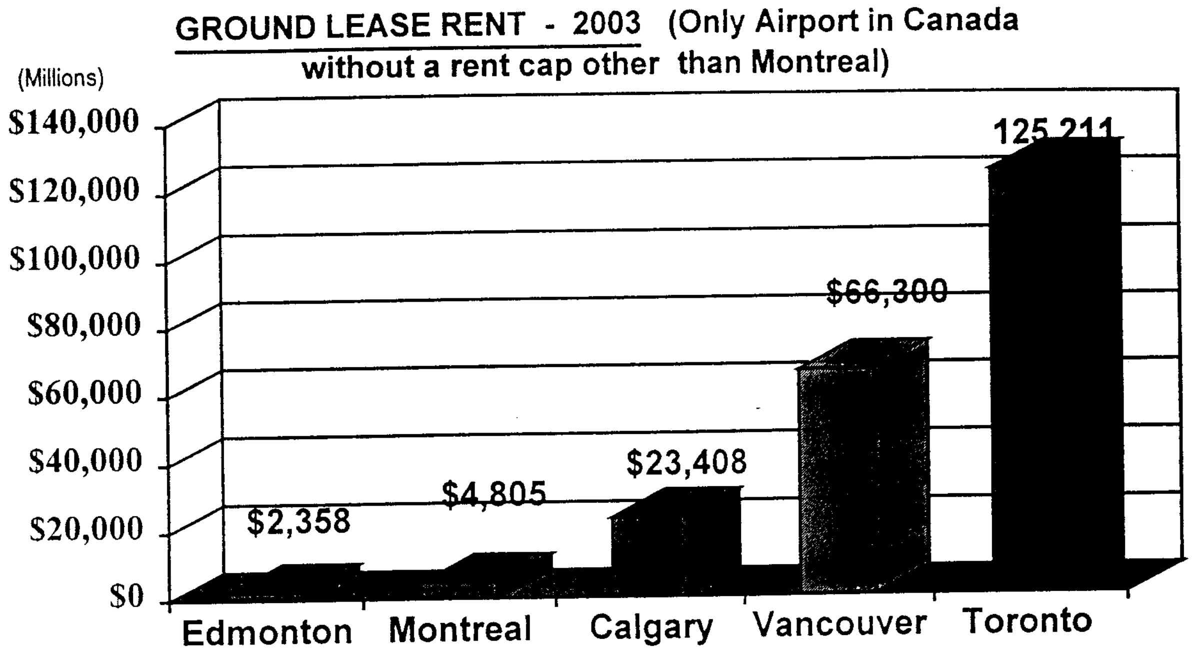
- Between 1992 and 2003 the Airport Authority paid over $600 million in ground lease payments. In 2004 alone, Vancouver's rent will jump by $6 million to $72 million. If nothing changes, over the next four years (2004-2007) Vancouver will pay over $330 million in rent. The rent paid by the Airport Authority between 1992-2003 greatly exceeds both the historical cost ($255 million) and the net book value ($167 million) of the assets transferred to it.

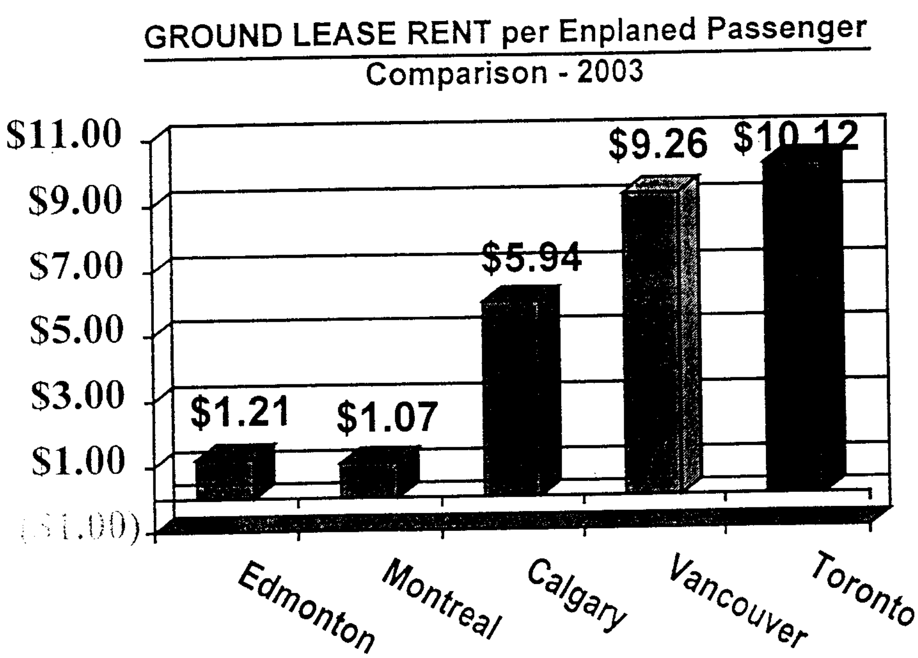
- In April 2004, the Canadian Airports Council ("CAC") sent a letter to Ministers Valeri and Goodale asking that the federal government:
  - Reduce total rent throughout the airport system by 50% and eliminate rent entirely for all but the eight largest airports;
  - Revise the airport rent formula so that future increases are directly and proportionately tied to changes in passenger and freight traffic; and
  - Eliminate the obligation imposed on some airports to make payments on chattels acquired from the government at the time of transfer.

- The CAC put forward a formula in May 2002 for the division of federal rent among airports that was agreed to by the individual airport authorities and is, in Vancouver's view, transparent, reasonable, sustainable and fair to all parties.

- The return from Vancouver International Airport should be economic growth not rent. Urge the federal government to make resolution of the rent issue a top priority.

Vancouver Ground Lease Payment Comparisons





Summary of Rent Issues

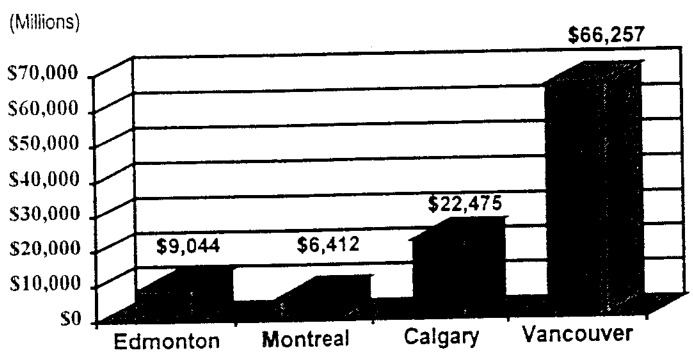
1. Background

- A reduction in federal rent is important to the sustainability of Canada's aviation industry. It would provide immediate financial benefits to the airlines and airports as they struggle to recover from the impact of September 11th, SARS, the Iraq War and the weak economies of the U.S. and other trading partners. Rent reduction has the added advantage of assisting all airlines—rather than providing relief to any single carrier.
- In June 2001, the Government of Canada announced that it would review the rent policy for leased airports in the National Airports System. The review is in response to the demands of airports and aviation communities and to the concerns expressed by the Auditor General in October 2000. Its goal is to ensure that the federal government's airport rent policy balances the interests of all stakeholders, including the air industry and Canadian taxpayers. Transport Minister Valeri confirmed that the Martin Administration would continue the Rent Policy Review and he recently told the House of Commons Standing Committee on Transport that Transport Canada should complete the study in spring 2004.

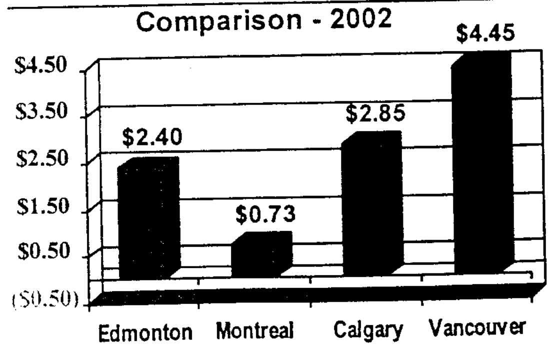
2. Inequity

- Vancouver International Airport was one of the first airports to be transferred. Subsequent airports were transferred under more favorable lease arrangements, which included a cap on rent.
- Edmonton and Calgary who were transferred at the same time as Vancouver also received a rent cap in subsequent negotiations with Transport Canada. Other than Montreal, which pays minimal rent, Vancouver is the only airport in Canada without a cap on rent.
- As a result. the Airport Authority faces an ever increasing rent payment and pays well in excess of the national average rent per passenger.

GROUND LEASE RENT - 2002 (Only Airport in Canada without a rent cap other than Montreal)



GROUND LEASE RENT per Passenger Comparison - 2002



- The rent to the federal government or "ground lease rent" is the single biggest cost of running Vancouver International Airport—and most other airports that pay federal rent. It takes over 25% of the total airport revenues. For certain revenue streams, the government's participation rate is even more exorbitant. For example, the ground rent is 92% of the lease revenue for land leases that were assigned to the Airport Authority in 1992 and amounts to over 50 cents for every retail and food & beverage concession dollar the Airport Authority receives from its tenants.
- Between 1992 and 2003 the Airport Authority paid over $600 million in ground lease payments. If nothing changes, over the next four years (2004-2007) Vancouver will pay an additional $330 million in rent. The rent paid by the Airport Authority between 1992-2003 greatly exceeds both the historical cost ($255 million) and the net book value ($167 million) of the assets transferred to the Airport Authority.

3. New Rent Formula Required

- In October 2000, the Auditor General of Canada released a report on Transport Canada and its handling of the transfer of airports to local authorities. With regard to the ground rent negotiated among the divested airports, the Auditor General stated: "Transport Canada cannot demonstrate how the details for the transferred airports are equitable, uniform, consistent and fair with one another as the government directed."
- The Canadian Transportation Act Review Panel in its final report dated August 2001 said: "The current formula, however, linking lease payments to net revenues, reduces incentives for cost minimization. A simplified formula based on passenger traffic would be more consistent with a governance regime aimed at efficient management."
- The Vancouver International Airport Authority is willing to pay a reasonable equitable rent to the federal government. Vancouver, along with the Canadian Airports Council ("CAC") –an organization representing Canada's privatized airports, has expressed its willingness to work with Transport Canada to find a revised rent formula; a formula that will help ensure the viability of Canada's airports.
- The Canadian Airports Council has submitted rent proposals based on passenger traffic to Transport Canada; the most recent proposal was presented in May 2002. The CAC proposals addressed the current inequity between airports in terms of the magnitude of lease payments and the escalation of those payments versus passenger levels. They also provide the federal government with an adequate return on its investment, that would rise as airports grow, as well as recovery of its net airport system costs.

4. Benefits of Reduced Rent

- As noted earlier, the aviation industry is under intense pressure due to the economic downturn events of September 11th, the Iraq War, SARS and Air Canada entering into CCAA. However, even in the best of times the profit margins at an airline are slim. A portion of airport rents are recovered from fees and charges to the air carriers. The airlines would benefit from a reduction of rent, and they, in turn, could pass on savings to the public.

- The Airport Authority thinks that made-in-BC dollars could be better spent here at home on additional airport improvements to keep British Columbia and Canada competitive. The return from airports is national economic growth...not rent.

RECOMMENDATION

- The Airport Authority seeks a principled approach to detailing with this issue, which would involve:
  - The establishment of a new philosophy and methodology for aggregate rent from all devolved airports in Canada. The new philosophy must be transparent, reasonable and sustainable.
  - The Airport Authority believes that the principles of transparency, reasonableness and sustainability can best be met by the adoption of a cost-based methodology, one that incorporates a reasonable return on the government's historical investment in airport infrastructure and allows the Government to recover net airport system costs.
  - This new methodology would, as a consequence of having a rational cost basis include a cap on the base rent of $50 million; the elimination of participation rent and restrict annual adjustments to reflect the increase in airport system costs to the lesser of inflation or passenger growth.

Draft Resolution
Re: Federal Aviation Policies and BC's Competitiveness

WHEREAS the Vancouver International Airport is an economic generator and facilitates job creation province wide with the most recent economic impact study showing that the airport is responsible for a total economic output of $5.183 billion and 54,182 person years of employment;

AND WHEREAS the connectivity provided by the airport is essential both to keeping British Columbian companies competitive in a global economy and to attracting new economic development and high quality jobs to the Province;

AND WHEREAS only 40% of Canada's current bilateral air treaties with other nations allow access by foreign carriers to YVR;

AND WHEREAS this restrictive International Aviation Policy puts the Vancouver International Airport at a competitive disadvantage with U.S. West Coast airports and prevents it from maximizing its potential as a Gateway between Asia and North America;

THEREFORE BE IT RESOLVED that the City of Richmond urge the federal government to:

1. enter into immediate negotiations with the United States for a true Open Skies agreement including fifth freedom rights;
2. pursue planned aviation negotiations with the Government of China to seek substantial liberalization and improved market access; and
3. introduce Canada's own Open Skies aviation policy and pursue it on a global basis with its trading partners;

AND BE IT FURTHER RESOLVED that this resolution be conveyed to the UBCM, LMMA, Federation of Canadian Municipalities, requesting there support, and the provincial and federal governments.

Vancouver International Airport Authority
Briefing Note

International Air Policy

- The Vancouver International Airport Authority supports an open and competitive international air policy environment, which will benefit both communities and air carriers. It is time for the federal government to liberalize Canada's air policy.

- Transportation is key to a nation's economic development, especially its ability to be competitive in a global economy. Recognizing this, other countries, notably the United States and European Union, have aggressively pursued air policy liberalization. The United States has now negotiated 62 Open Skies agreements.

- Canada is lagging behind. Today only 40% of Canada's bilateral aviation agreements allow foreign carriers access to Vancouver. Many of those that allow access put restrictions on the level of service, which effectively makes a potential service unviable. Recent examples of carriers that have expressed an interest in Vancouver, but cannot come here, include Emirates and Air Tahiti Nui (an airline of France).

- Airports are economic generators spinning out employment and development opportunity. One take-off by a 747 generates over $79,000 of economic activity. Vancouver International Airport has a total economic output of nearly $5.2 billion. Canada needs to assess the benefits of more liberal aviation agreements to communities and to Canada as a whole.

- Canada should begin liberalizing current international aviation policy by:

  - Immediately entering into discussions with the U.S. to set up negotiations for a true Open Skies agreement including fifth freedom rights. Fifth freedom rights are essential to developing Vancouver as a Gateway between Asia and North America and capturing Canada's share of the rapidly growing Asian aviation market. The U.S. government has said that it is ready to talk about such an agreement. Talks should include exploration of the net benefits that a "Common North American Aviation Market" would create.

  - Proceeding with planned talks to liberalize the air services agreement with China. The United States and China finalized a new bilateral air services agreement in July 2004 that significantly expands rights for both sides—a total of 195 new weekly flights for each country at the end of the phase in period. This agreement puts Canadian communities at a significant competitive disadvantage due to Canada's highly restrictive air agreement with China. As noted above, fifth freedom rights with the United States would allow Canada to maximize more fully any expanded aviation rights with China.

BACKGROUNDER

International Air Policy

The Vancouver International Airport Authority supports an open and competitive international air policy environment, which will benefit both communities and air carriers.

Airlines around the world are undergoing major structural change. As they emerge from the crises of 9/11, SARS, and weak global economies and undergo financial restructuring, airlines will look at their routes as a blank page. If Canada continues its restrictive international air policy, Canadian communities will lose this important window of opportunity to attract new air services and the jobs that they create.

Canada cannot afford the façade of liberalization through tiny steps. Given that Vancouver competes for international traffic with major U.S. West Coast airports, any policy less liberal than that of the U.S. places Vancouver International Airport ("YVR") and its community at a significant and growing competitive disadvantage.

A broad spectrum of business, community and airline stakeholders have been urging the federal government to move forward with liberalization. Canada's major trading partners, the U.S. and the European Union, are currently engaged in negotiations for a TransAtlantic common aviation area. Canada cannot afford to be left behind.

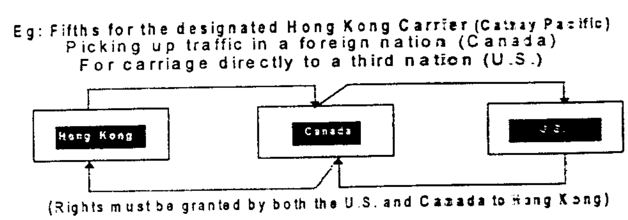
Background and Issues

Canada's international aviation strategy remains far too protectionist, especially when compared with that of its major aviation partners, the United States and the European Union. Over the past five years, Canada's policy has been one of inaction, whether it be moving forward on liberalizing its domestic and international air policies, participating in multilateral initiatives such as GATS, taking a leadership role at ICAO or evolving the Trans-Atlantic relationship with the European Union.

Open Skies

Canada and the U.S. last modernized their air services agreement in 1995. While that agreement successfully demonstrated how large the benefits of liberalization can be, it falls significantly short of what the U.S. defines as an "Open Skies" agreement.

The U.S. has negotiated 60 "Open Skies" agreements. Canada is not included because a key ingredient, open fifth freedom rights, is missing from the agreement. These rights are **critical** to the development of the Vancouver Gateway and this community.



Fifth Freedom Rights

An example of a fifth freedom right is Cathay Pacific is entitled to carry Canadian passengers and cargo between Vancouver and New York as part of a Hong Kong-Vancouver-New York service. Air Canada currently can exercise fifth freedom rights between Honolulu—it is allowed to pick up U.S. passengers--and Sydney on its Vancouver-Honolulu-Sydney service.

Vancouver is fortuitous in having a strategic geographic advantage. It is closer to Asia than its U.S. West coast competitors. However, without fifth freedom rights it cannot take advantage of this position.

Foreign Carrier Access

Air negotiations traditionally have focused on Eastern Canada, notably Montreal and Toronto. Only 40% of Canada's air treaties allow foreign carriers access to YVR. This compares to nearly 75% for Toronto and over 90% for Montreal, not exactly equitable!

Noteworthy is the absence of access for foreign carriers' own equipment into YVR from several key countries. Examples include Thailand (Thai Airways), Chile (Lan Chile) and France (Air France). Several agreements specify Vancouver on the route schedule, yet are structured such that service cannot be commercially viable, e.g. Malaysia. Vancouver, therefore, cannot replace services dropped by Air Canada when it chose to reduce its service to Asia or attract service from new markets that Air Canada or another Canadian carrier do not want to serve.

Foreign carriers can also be capacity constrained. EVA Airways, a Taiwanese carrier, is restricted to a maximum of three weekly frequencies with no beyond or fifth freedom entitlements. The carrier has unsuccessfully sought daily frequency and beyond rights.

Cargo

Canada has no international air cargo carrier, which has resulted in minimal emphasis on the air cargo industry. This has clearly been to the detriment of Vancouver and to the advantage of our West Coast competitors. Cathay Pacific, the only international all-cargo carrier at YVR, accounts for less than six percent of outbound cargo capacity. This compares with other West Coast airports such as Seattle, San Francisco, Portland and Los Angeles where freighters account for 30-40%. Anchorage, a progressive and growing air cargo gateway, carries 88% of its cargo on freighters.

Vancouver, along with most markets in Canada, is too small to support all cargo services on its own. Currently, a full one-third of British Columbia's international exports by air are trucked to U.S. West Coast airports and placed on airplanes there. For Vancouver to attract foreign freighter services, such carriers will need fifth freedom rights to serve the larger U.S. beyond market. U.S. all-cargo carriers must be able to exercise fifths from Vancouver to Asian markets. Since these carriers have adequate alternative U.S. gateways, Canada cannot expect to extract a price for such rights.

Though the incremental benefit to the carriers is marginal, the spin-offs to Canada in terms of generating trade, employment and enhancing business would be substantial. It also should be noted there is little overlap between the type of freight carried in the belly of passenger aircraft such as Air Canada and WestJet and the cargo that is carried on freighters.

Domestic Policy

In today's environment domestic and international air policy are intertwined and must be linked. The absorption of Canadian Airlines by Air Canada, impeded the ability of non-Star Alliance carriers (i.e., carriers in the Oneworld and Skyteam alliances) to serve secondary markets in Canada, for example Kelowna from YVR. These carriers became more reliant on local origin and destination traffic and hence less competitive.

The concept of "Right of Establishment" would address this imbalance. Such a policy would permit a foreign entity or carrier, operating as a Canadian subsidiary, to provide domestic service. The airline would operate Canadian registered aircraft, follow Canadian rules and regulations, and employ Canadians. The benefit to British Columbia is that it would provide much needed competitive access to secondary communities.

Some espouse the fear that allowing right of establishment would result in major U.S. carriers cream skimming high traffic routes in Canada. The record in Europe, however, has been the establishment of new regional airlines which created significant competitive benefits for secondary markets. In the Canadian situation, we anticipate that the benefits would be focused on regional services enhancing beyond-the-gateway access for foreign carriers delivering tourists to Canada.

RECOMMENDATIONS

The following initiatives, in order of priority, will result in significant net benefits to all Canadian stakeholders, not just the traditional "airline-centric" interests.

1. **Canada introduce an "Open Skies" policy** including open and unlimited Fifth Freedom Rights.
   - ✓ **Priority:** The U.S. has told the Martin government that it is ready to begin negotiations on a true Open Skies air transport agreement between Canada and the U.S. Canada should accept this offer now. Talks should include exploration of the net benefits that a "Common North American Aviation Market" would create.
   - ✓ Ask for a seat at the table in the ongoing U.S. – E.U. negotiations on a Transatlantic common aviation area, but do not allow this to slow down Open Skies with the U.S.
   - ✓ Pursue such an Open Skies policy globally on a reciprocal basis for passengers.
   - ✓ Immediately implement on a unilateral basis an Open Skies policy for all-cargo services. Canada should consider incorporating all-cargo services under GATS.

2. **"Right of Establishment"** - allow a foreign airline or entity (up to 100% foreign owned) to set up a Canadian subsidiary for domestic-only services. The benefits for Canada would include enhanced access for foreign carriers to beyond gateway markets that are currently limited, added capacity and choice for smaller secondary communities, and may address the shortage of investment capital. This concept is <u>not</u> cabotage.

3. **Foreign ownership** – increase permissible level from 25% to 49%; consistent with what the U.S. is contemplating and in line with the E.U. many other countries.