
Pricing

New passenger charges at Adelaide Airport

In October the Commission released its decision to allow a 'passenger facility charge' (PFC) of \$4.09 per arriving and per departing domestic passenger to be introduced at Adelaide Airport. A charge of \$1.00 was determined for regional and \$6.00 for international passengers.

Adelaide Airport is proposing to build a new passenger terminal to combine the airport's domestic and international passenger processing functions. The multi-user integrated terminal (MUIT) will replace the existing separate domestic and international terminals.

The cost of the project is some \$200m, with the 'aeronautical' component being around \$150m. The need to upgrade facilities is widely accepted by the industry and airport users. Adelaide Airport argued that combining all terminals in the MUIT is an efficient way to provide these facilities.

Adelaide Airport applied to the Commission to allow it to exceed the price cap by charging arriving and departing passengers a fee. These fees would cover the 'aeronautical' costs of the project.

The charges approved by the Commission were the same as those requested by Adelaide Airport except that the proposed charge of \$4.45 for domestic passengers has been reduced to \$4.09.

The PFC would provide for:

- recovery of the 'aeronautical' component of construction costs;
- recovery of the cost of a refuelling facility which is currently considered to be outside the price cap;

- a rate of return on the 'aeronautical' component of Adelaide Airport's investment; and
- a contribution to additional operating costs associated with the new facility.

Adelaide Airport derived the PFC by using a discounted cash flow analysis of the project. The cost recovery period is 15 years from when the MUIT begins to operate.

The regulatory framework that covers privatised, core-regulated airports provides that aeronautical charges are subject to a CPI-X price cap. However, an airport operator may apply to the Commission for increases in charges to fund 'necessary new investment'. In assessing the proposal the Commission must take account of relationships between the proposed charges, costs and support from users for the proposals.

Adelaide Airport first approached the Commission in October 1998 and discussions led to a formal proposal on which the Commission published its draft decision in May 1999. After a public consultation process, and additional information provided by Adelaide Airport was assessed, the Commission published its decision on the proposal in October 1999.

Support of airport users

The MUIT

Submissions to the Commission's draft decision expressed broad support for the scope and scale of the MUIT. Letters of endorsement from other airport users (such as exporters, the tourism and hospitality industries, and the South Australian Government) indicated support for the proposal. The Commission was not aware of any objections to the construction of an MUIT or to its basic design and was satisfied that the concept of a PFC had the support of a range of users.

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Qantas and Ansett raised various concerns about the proposed prices particularly the use of a pre-tax real weighted average cost (WACC) to estimate cost of capital. The decision addresses some of the airlines' concerns but commercial negotiations between the airlines and Adelaide Airport on pricing of non-aeronautical services are continuing.

Regional airlines

Adelaide Airport addressed the concerns of regional airlines by setting three different prices, one for domestic users, one for domestic regional airline passengers and a third and higher one for international passengers. The regional airlines and other users supported this approach as it reflects the differing levels of use of the proposed facility.

Cost allocation

The regulatory regime applying to privatised airports effectively requires the airport operator and the Commission to separate the airport into its aeronautical functions and its non-aeronautical functions. The price cap applies only to charges for aeronautical services.

Adelaide Airport has taken what may be described as an 'incremental' approach to cost allocation. The decision states that the Commission does not necessarily agree with Adelaide Airport's approach to cost allocation. The main concern is with areas used for both aeronautical and non-aeronautical functions. As an example, a corridor may provide access to a passenger lounge but also service retail shops.

The Commission decided to allocate costs of shared facilities using a physical cost driver where possible, and otherwise a simple allocation rule.

The rate of return

The approach Adelaide Airport adopted mostly followed the Commission's approach in the report on the Victorian gas access arrangements. Essentially, this means calculating the cost of capital in a pre-tax real weighted average cost form. Using this method, Adelaide Airport proposed a cost of capital of 8.97 per cent whereas the Commission used a figure of 8.00 per cent for

its assessment. The two issues that attracted the most interest in submissions were asset beta and tax.

Asset beta

Adelaide Airport derived its asset beta by referring to the equity betas of publicly listed airport operators from Austria, Denmark, New Zealand and the UK. From the range of observed betas Adelaide Airport chose the upper end (Auckland's) beta of 0.66 whereas the Commission decided that an average of 0.61 was more appropriate. The question of which beta is relevant attracted considerable comment during the public consultation process, with airlines arguing that it was too high and airport operators that it was too low.

Tax

A statutory tax rate of 30 per cent is used for calculating the WACC. The 30 per cent rate used is the expected statutory tax rate post the Ralph Report. Given that the Ralph Report proposals have not been legislated the difficulty for the Commission was uncertainty about the rate. The approach adopted in the decision was to use the 30 per cent rate, but to allow for a revision of the PFC if it does not eventuate.

Passenger forecasts

The PFC was based on the passenger projections proposed by Adelaide Airport. In its initial application, Adelaide Airport used external consultants to forecast passenger numbers for the 15-year period of the PFC proposal. In August 1999, after the release of lower than expected passenger numbers for the 1998-99 financial year, Adelaide Airport advised the Commission it believed its original forecasts could not be achieved and submitted revised forecasts (also prepared by consultants). The Commission consulted with the major airlines which considered the revised passenger forecast were not unreasonable.

Since submitting the revised passenger numbers, Adelaide Airport has proposed a review process which would revise the PFC based on an assessment of actual passenger outcomes against the forecasts. The decision supports a review of passenger forecasts immediately before the PFC is implemented and every three years thereafter.