Airways' Proposed Pricing Consultation

Submission Template

To assist with making submissions, this template lists the feedback questions set out in Airways' Proposed Pricing for the 2022 - 2025 Period Consultation Document, April 2022. You are welcome to comment on other topics relating to the proposed pricing should you wish to.

Once you've read the Consultation Document, you can download this template, open in Microsoft Word and type directly into the spaces provided. Primary submissions are to be emailed to submissions@airways.co.nz by 29 April 2022. The same template can be used for cross-submissions if it's helpful. Any cross-submissions are to be sent to the same email address by 13 May 2022.

Important note for submitters

Please note that we will publish all submissions on our website. This is an important step as it allows us to run a transparent consultation process and enables others to consider whether they wish to make cross-submissions. However, if you wish to provide Airways with confidential information in a submission, you must supply both confidential and public versions of your submissions. The public version will be the one published on our website. The responsibility for ensuring that confidential information is not included in a public version of a submission rests with the submitter.

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Consultation feedback questions

Section: Operating Costs

Q1: Do you agree that Airways' forecast of base operating costs is appropriate in light of the objective of maintaining safe and efficient services?

Feedback:

IATA supports efforts to maintain safe and efficient services, however we have the following observations and clarification requests before we can provide final determination for this proposal:

- 5.1Aa states that "pressure has come on staffing levels due to the number of in-flight projects and initiatives, roster resilience to manage COVID-19 and the contingency to move into the new operational facilities".
    - Are staff that are engaged to run projects taken from operational rosters at ATC salary levels?
    - If project staff are sourced externally, are they contracted only for the term required within the project timeline or hired as fulltime permanent staff?
    - Can you please provide a more detailed breakdown of the operational costs of staff allocated to project work?
- 5.1Aa also states that Airways has "an aging operational workforce which requires proactive recruitment due to the comprehensive and intensive training pathway to qualification".
    - Can we expect a lower FTE count once the move into new operational facilities has been completed and there is no longer a 'bow-wave' of operational staff required to run programs such as 'ghosting'?
    - Are baseline ATC FTE numbers expected to increase, decrease or remain stable throughout the pricing period?
    - As the aging workforce is replaced by new recruits, does this mean a drop in labour costs, and in particular ATC salaries, as the new ATCs will be starting on lower pay bands?
    - Further, it is impossible to assess if the forecast is appropriate given that collective agreements are still under negotiation.

Q2: Recognising that the inflation inputs will be updated with current information at the time of setting final prices, do you agree with Airways' inflationary inputs?

Feedback:

There are still too many unknowns in the inflationary inputs to provide agreeance.

- Regarding inflationary uplifts: when will the collective employment agreements with NZALPA and AMEA be finalised? Given that employee wages are a significant component of OPEX which is 70% of cost-base, it is difficult to make a determination on the appropriateness of applying NZIER LCI. More importantly, would inflation normally be included in a collective agreement and therefore it would not be necessary to apply again to that component of the cost-base?

- NZIER's Primary Producers Index (PPI) (inputs) are accepted as appropriate reference for general cost increases (excluding depreciation).

Q3: Recognising that the capital charge inputs will be updated with current information at the time of setting final prices, do you agree with the inputs into Airways' capital charge calculation?

Feedback:

IATA has the following observations and requests for clarification before we can agree with Airways' capital charge calculation:

- The risk-free rate is currently input as 1.7%, however Figure 7 notes that "this will be updated to reflect the current risk-free rate at the time of setting the final prices. At the time of writing, the NZCC released its latest determination which has a three-year risk-free rate of 1.96%". This is already ¼% higher. Confirm 1.96% will be used or could the rate potentially be higher by time of pricing decision? How will it affect the final capital charge rate?
- Our feedback suggests that gearing should be 19% to be consistent with the NZCC decision on airports. Airways should be ensuring their WACC assumptions are internally consistent and if they are adopting an airport asset beta, they should adopt the gearing profile as well.
- Our feedback suggests that Airways' adoption of their target leverage is inconsistent with NZCC principles. Monopolies should be adopting an efficient gearing set by looking at external comparators to mitigate against Airways having an unintended but consequential potential risk of being incentivized to increase gearing.
- Analysis in 2019 assessed Airways actual gearing at 40%, however WACC at that time appeared inflated by adopting 55% as the ratio.
- Proposed WACC range is set at the 67th percentile which is the same as for setting gas and electricity prices. This is the same as previous pricing periods where it was questioned whether the industry comparisons were appropriate? Feedback is that 50% should be adequate for returning a profit.
- The Market Risk Premium (MRP) is currently set at 7% for previous decisions. Airways estimates that NZCC might revise this to 7.5% in May 2022, however we contend that 7% (as per airports) remains valid.
- The capital charge proposed rate is 7.01%, however we would like to see the final rate based on decisions for current variables.

Section: Proposed capital plan

Q4: Do you agree that Airways' investment programme is appropriate to enhance safety and system resilience, while transitioning to digital services over time?

Feedback:

IATA has the following observations and requests for clarification before we can agree with Airways' proposed capital plan:

- Regarding the change to treatment of WiP - is it possible to see an example calculation using the new capital charge design of a WiP to determine if it results in a higher cost-base addition versus being recognized during development as in previous years?
- New Auckland Tower – given the financial impacts of recent years, airline feedback indicates a preference for maintaining the current tower for this pricing period and deferral of the replacement plan.
- Notwithstanding the preceding comment, if the costs shown for Auckland Tower are for replacement, why are they spread over three years when it would be considered a WiP with costs shifted to a time when it has commenced delivering services?
- $34m over the period for Primary and Secondary radar replacement – PSR remains the system of choice for the identification of unknown or unlawful airspace intrusions. This is a national security service and the infrastructure cost should be borne by the State's national security budget, and not by air navigation fees for civil aviation. IATA's global position on PSR is that upgrades or new deployments are not supported as a means to surveil airborne civil aircraft. For this application, SSR, MLAT and ADS-B have vastly superseded this technology. Therefore, user charges associated with future upgrades or new PSR installations should be removed.
- $6.3m for drone management – this is a State cost that should be recovered through the UAS users and removed from the cost-base of ANS charges.
- IATA has no objection to Airways' divestment of airfield power and lighting assets costs to Auckland Airport.
- Re en-route DVOR replacement- IATA supports the transition to GNSS as the primary means of navigation and recommends minimum reliance on VOR as contingency for GNSS. While maintenance of existing installations is supported where they are agreed by Airspace Users as still being required, IATA doesn't support deployment of new VORs and encourages Airways to continue to plan and publish a rationalization plan of unnecessary VORs under an agreed timeline. If other Airspace Users (e.g. the military) require a more extensive network of terrestrial navaids due to fleet equipage limitations or other factors, these should be funded separately by the relevant user or the State
- Key projects include "replacement of the Aeronautical Information System (AIM) required on aircraft flight decks and for air traffic control" – can Airways provide more detail on the elements of this project and related procurements or development of systems?
- 5.1Ac states that "Several end-of-life property and navigational assets will also be decommissioned" – can Airways list these assets and identify where / when their removal will be from the cost-base?

Section: Assumed industry recovery

Q5: Do you consider the position taken for domestic recovery is reasonable? Are there other material factors that should be taken into account that may influence the domestic volume forecast?

Feedback:

- IATA does not object to Airways' forecast for domestic recovery as it appears reflective of the periodic recoveries that occurred earlier during the COVID period following the relaxation of restrictions.
- Given the rapid growth expected in domestic and international traffic in the post-COVID-19 recovery, we suggest that there should be another forecast six months into the first year of the new pricing period to support re-assessment of rates, similar to the annual review for risk-sharing.

Q6: Do you consider the position taken for Trans-Tasman recovery is reasonable? Are there other material factors that should be taken into account that may influence the Trans-Tasman volume forecast?

Feedback:

- IATA does not object to Airways' forecast for Trans-Tasman recovery as it appears reflective of the periodic recoveries that occurred earlier during the COVID period following the relaxation of restrictions.
- Given the rapid growth expected in domestic and international traffic in the post-COVID-19 recovery, we suggest that there should be another forecast six months into the first year of the new pricing period to support re-assessment of rates similar to the annual review for risk-sharing.

Q7: Do you consider the position taken for other international recovery is reasonable? Are there other material factors that should be taken into account that may influence the other international volume forecast?

Feedback:

- Airways' forecast for recovery of international travel is consistent with IATA's latest passenger forecast for international traffic recovery for New Zealand.
- IATA maintains regular reviews of passenger forecasts given the ongoing risks posed by future possible mutations of COVID and related government reactions.
- Given the rapid growth expected in domestic and international traffic in the post-COVID-19 recovery, we suggest that there should be another forecast six months into the first year of the new pricing period to support re-assessment of rates, similar to the annual reviews for risk-sharing.

Section: Proposed prices for FY23-FY25

Q8: Do you agree that Airways' proposed increase is necessary and appropriate to maintain safe and efficient services at lower volume levels?

Feedback:

IATA acknowledges the welcome support provided by the New Zealand Government to the aviation sector, including Airways New Zealand, during the COVID-19 crisis.

In terms of sector performance in the post-COVID period, there does not appear to be any viable way to ensure timely recovery without continued government funding. Increasing ANS charges before airlines can re-establish scheduled flights potentially creates an endless loop that results in slower recovery of traffic numbers and therefore less ANS revenue. Governments can help sustain recovery by meeting the gap in revenue required to deliver services until volumes of movements are sufficient and stable, and levels of revenue reach break-even points (full cost-recovery).

The ongoing need for government support depends on the speed of growth during the recovery period. To drive growth ANSPs should consider reducing current charges in order to stimulate flight numbers, which are the revenue driver. In terms of elasticity of demand, a combination of lower charge rates with higher numbers of flights would increase ANSP revenue more rapidly. Alternatively, maintaining or increasing charges will potentially result in slower growth in flights as airlines maintain strict cost containment strategies.

If a reduction is offered, a gradual return to a new cost-recovery level could be accommodated through the same theory as a 'step-climb' in ATC (i.e. where an aircraft is only cleared to a level beneath another aircraft once the higher flight has already passed a higher safe flight level). In the charges case, this would mean linking incremental increases in charges rates to traffic levels first passing growth milestones, e.g.: for a 50% discount, a 5% increase in charges could apply each time movements have increased by another 10%. This way increases are tied to real increases in traffic as opposed to being applied at arbitrary time periods. Even without a charges discount, any proposed introduction of increases should consider a similar approach.

Q9: Recognising that the inflation inputs will be updated with current information at the time of setting final prices, do you agree with the inflationary inputs used to uplift GA prices?

Feedback:

IATA has no objections to the inflationary inputs used to uplift GA prices.

Q10: Do you agree with the proposed changes to Milford prices?

Feedback:

IATA has no objections to the proposed changes to Milford prices.

Section: Scorecard

Q11: Would you find it useful to receive the Scorecard metrics in Appendix 3?

Feedback:

IATA anticipates value from information to be shared by the proposed scorecard and supports its use in the current format and for any subsequent reviews to improve its content or presentation.

You are also welcome to provide feedback on other topics relating to the proposed pricing.

Feedback:

The airline industry has been in an extremely precarious financial position for over two years now. The COVID-19 recovery, particularly in the Asia-Pacific region, remains fragmented and uneven. International borders are reopening inconsistently, and strict travel rules have restricted passengers from flying and constrained airlines from growing their schedules again. Thankfully many of the restrictions have now been or are being relaxed, however every single cent of airline expenditure remains under close scrutiny and must deliver a benefit.

Airlines continue to face costs and charges from a broad range of inputs that are necessary for flights to continue and traffic to grow. ANS Charges are but one of many State agency charges airlines must factor into their strategic planning and day-to-day financial management. To ensure that the Asia Pacific region can start recovering from the impacts of COVID-19 and continue to realize the broad and deep economy-wide benefits offered by air transport, whole of government support for aviation is required. This must include government support for key system enablers like Air Navigation Service Providers (ANSPs) in order to avoid unsustainable charges increases that airlines and their passengers will struggle to absorb.