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IN BRIEF

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Allison Padova
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Airport Rent: Facts and Figures

As a result of a federal government program of divestiture and transfer, the Canadian airport system was transformed from a net expenditure for the government to a net contributor to the treasury. In 1991-1992, the airport system cost the government roughly $58 million, but by 2003-2004 it generated net revenues amounting to some $115 million. The positive balance is a result of dramatic reductions in the government's operating and capital costs after not-for-profit authorities took over the management, financing and operation of the largest and busiest airports in Canada. The net revenue currently generated by the airports system is attributable to the rent payments airport authorities (AAs) make to the federal government for the leased airport assets.

Airport rent paid in 2003-2004 amounted to $224 million. It is forecast to grow to some $349 million by 2007-2008. Industry participants and observers, including the Auditor General of Canada, have suggested that the current airport rent policy is flawed. Among other things, Transport Canada has been accused of not establishing the proper basis for making rent calculations and having applied the methodology inconsistently. Furthermore, some have suggested that the current rent policy threatens the long-term financial viability of airports and negatively affects other areas of the industry.

Transport Canada (TC) commenced a review of the rent policy following repeated expressions of concern by stakeholders and a report by the Auditor General released in October 2000. The review was to be conducted concurrently with the development of the *Canada Airports Act*. The Act was introduced in the 2nd session of the 37th Parliament as Bill C-27, but died on the Order Paper in November 2003. The rent policy review has been completed and TC officials are developing recommendations for review by Cabinet.

BACKGROUND

Twenty-six of the 726 certified airports in Canada have historically handled over 90% of total passenger traffic. The National Airports Policy of 1994 designated these 26 airports as the National Airports System (NAS) and slated 23 of them for transfer to the AAs on long-term leases.(1) The AAs, largely comprising representatives from each airport's community, manage the finances and operation of the NAS airports according to commercial principles and the requirements of local users. After transfer, Transport Canada's role in the airport system was transformed from owner and operator to *landlord* and regulator.

No legislation was introduced to govern the AAs after the transfers were completed. Instead, the conditions of transfer, including the terms of airport financing, operations and governance, for each airport were set out in the facility's "ground lease." All 26 National Airports System airports have now been transferred to local authorities or divested to provincial or territorial governments.

THE PRINCIPLE AND STRUCTURE OF AIRPORT RENT PAYMENTS

Rent payments were intended to provide the Government of Canada with reasonable compensation for the NAS airport assets it continued to own. Individual airport payments were to be no less than the net cash flow that would have accrued to the government if it had continued to operate the airport. Payments based on the "base case" revenue forecasts were termed as "base" rent payments. Furthermore, the rent formulae were structured to allow the government to share in 1) revenues in excess of what Transport Canada forecast would be generated under AA management, and 2) the risks of increases in inflation and/or declines in traffic. Positive or negative amounts computed based on excess revenues or unexpected changes in inflation or traffic were termed "participation" rent payments.

All of the rent formulae, which differ slightly from airport to airport, consider three streams of airport revenues to compute "base" and "participation" rent payments:

- **Airside and general terminal.** Revenues include landing, fuel and parking charges from airside operations and fees for using counters, gates and lounges in the terminal.

- **Concessions and commercial.** Revenues include rent from shops, parking facilities, hotels and office space.

- **Non-core commercial and industrial real estate.** Revenues consist of rent from airport land used by commercial or industrial real estate projects.

Rent payments accrue to the Consolidated Revenue Fund, not directly to TC.

AIRPORT RENT PAYMENTS TO DATE

The net annual rent revenue grew from $20 million to $224 million (current dollars) between 1992 and 2003.(2) According to TC, most of the growth in net rent revenue is due to growth in the components of base rent, which are largely dependent on airport passenger volumes. Participation rent reportedly accounts for only a small portion of total rent revenues, as only the Vancouver, Montréal and Edmonton AAs pay certain components of it. The cumulative amount paid to the federal government in rent payments during this period was more than $1.6 billion.

The net annual rent revenues are plotted in Figure 1 against the available annual passenger traffic statistics. Apparently rent revenue is not particularly sensitive to changes in passenger volume. According to TC, the passenger volume caps in the base rent formulae make the relationship more of a step function than a proportional one. Also, rent fluctuations, which are permitted under the airports' ground leases, have caused rents to be artificially low in some years due to deferral and artificially high in others due to repayment. For example, the historic peak in rent at $299 million in 2002 is largely explained by a lump sum repayment of nearly $57 million in rent from Montréal that had been deferred in the 1990s. In contrast, some repayments of rent have taken place over a number of years, further distorting the underlying trend. TC states there would have been a more consistent upward trend in rent revenues had no deferrals occurred.

It is also interesting to note that:

- Lester B. Pearson Airport in Toronto was transferred to the Greater Toronto Airport Authority (GTAA) in 1996 and began paying rent in 1997. The GTAA has contributed 46% of the cumulative rent collected from 1992 to 2003, and paid 52% of the total rent in 2003.

- The Vancouver Airport Authority (VAA) took over Vancouver International Airport and began paying rent in 1992 (before the National Airports Policy was introduced). The VAA contributed 39% of the cumulative rent collected from 1992 to 2003, and paid 27% of the total rent in 2003.

- The Calgary Airport Authority (CAA) took over Calgary International Airport and began paying rent in 1992 (also before the National Airports Policy was introduced). The CAA contributed 13% of the cumulative rent collected from 1992 to 2003, and paid 10% of the total rent in 2003.

- Other AAs that were net contributors to rent revenues were those in Montréal, Ottawa, Winnipeg and Victoria, collectively amounting to some $135 million in net revenue up to and including 2003.(3)

- The other 14 transferred NAS airports were net recipients of nearly $91 million from the Government of Canada through transfer subsidies or rent deferrals from their date of transfer up to and including 2003.

According to TC, cross-subsidization between larger airports and smaller airports does not factor into the rent formulae in any way.

RENT PAYMENT FORECAST, 2004-2007

The NAS airports are expected to generate nearly $1.2 billion (current dollars) in net rent revenue to the federal government between 2004 and 2007. As shown in Figure 2, TC forecasts that total rent payments will increase by more than 50% over 2003, to $349 million in 2007. Most AAs that paid rent in 2003 can expect to see increases in rent payments ranging from 20% to 75% by 2007.(4) These increases are expected to result from growth in passenger volumes and base rent. Concession revenues, however, are not forecast to be a major growth component.

With respect the rent payment forecast, it is also interesting to note that:

- Even more dramatic increases in rent over 2003 are forecast for:
  - the Edmonton Airports Authority, whose rent payment is expected to grow by more than 400%, from $2.4 million to $12.5 million;
  - the Aéroports de Montréal, whose payment is expected to grow by more than 200%, from $6.0 million to $18.4 million; and
  - the CAA, whose rent payment is forecast to grow by more than 100%, from $22.2 million to $48.3 million.
- The VAA's contribution is expected to fall to 25% (from 39%) of the total rent that is forecast between 2004 and 2007.
- AAs at Thunder Bay, St. John's, Regina and Saskatoon will begin to pay rent in 2006. The remaining eleven AAs will begin to pay rent some time after 2016.

MAIN CRITICISMS OF THE RENT POLICY

Various industry observers and participants have expressed concern about TC's airport rent policy. Specific criticisms from key sources are summarized below:

A. Auditor General of Canada

In chapter 10 of his 2000 Report to Parliament, the Auditor General concluded that TC did not determine the fair market value of the airport assets and business opportunities it was transferring. The Auditor General felt that, without this information, it would have been impossible for TC to ensure that the future stream of rent payments was fair. The Auditor General found that the airport rent formulae were applied inconsistently and that TC was unable show whether they had been applied equitably.

B. *Canada Transportation Act* Review Panel

In its June 2001 report, *Vision and Balance*, the Panel suggested that a formula based on passenger throughput at each site, rather than revenues, would be more likely to encourage efficient management practices. The Panel also observed that because rent payments are linked to *net* revenues (rather than gross revenues), there is little incentive for AAs to keep costs low.

C. Canadian Airports Council

The Canadian Airports Council's (CAC) position on federal rent at the NAS airports is as follows:

1. The government's review of its airport rent policy is long overdue.
2. Rents are too high.
3. The distribution of rent amongst the rent-paying airports lacks fairness and consistency.
4. Unless the rent policy is changed, rents will soon increase to significantly more unacceptable levels and will represent a major financial challenge.
5. Excessive rents are inconsistent with the mission of airports to serve as economic enablers for their local communities and regions.
6. The total airport rent paid to the federal government should be reduced by 50% and should be paid only by the eight largest airports.
7. Chattel payments (for capital equipment transferred with the airports) should be waived as an undue burden on small airports.

8. Future changes in rent should be tied to changes in traffic levels on a directly proportionate basis.

9. To resolve the inequities in the rent formulae, rent should be based on progressive formulae with the larger airports paying proportionately more than smaller ones.

10. If the government were to reduce rent levels, airports would pass on a significant portion of the saving to the rent-paying users.

D. Canadian Chamber of Commerce

As an advocate for business in Canada, the Canadian Chamber of Commerce proposed a number of measures to reduce the negative impact of airport rents on business:

1. The government should suspend rental payments by the airports for a two-year period, and the airports should pass the rental savings on to the air carriers.

2. A more transparent process for determining airport rents should be established.

3. Rents should be based on the real cost and expenses incurred by Airport Operators – leading to a substantial decrease in rents.

4. There should be a cap on the total rent that the Government of Canada extracts from individual airports.

5. All airport rents should be directed into an “airport reserve” rather than into the Consolidated Revenue Fund.

GOVERNMENT’S POSITION ON RENT POLICY

In the Auditor General’s chapter on Airport Transfers, it is stated that as the owner/landlord of the transferred airports in the NAS, the government is entitled to charge AAs for the use of the land and airport facilities. Furthermore, the apparently high growth in rent revenue was to be expected as, according to TC, the rent formulae were designed to lessen the burden on the AAs in the short term but to provide higher returns to the government in the longer term.

With regard to the allegation that it had not established fair market value for the airports it transferred, TC stated that it engaged a financial advisor to establish fair market value of the first four airports to be transferred. These valuations had been factored into the rent formulae for the airports.

The government has renegotiated transfer agreements with some airports, resulting in significant rent reductions. AAs in Edmonton, Calgary, Vancouver and Toronto will have received some $474 million in rent reductions when the adjustments have been fully realized in the next few years.

REFERENCES AND LINKS

Canadian Chamber of Commerce: http://www.chamber.ca/cmslib/general/T035.pdf.

Canadian Airports Council: http://www.cacairports.ca/Eng/Default.htm.

Auditor General’s Report: http://www.oag-bvg.gc.ca/domino/reports.nsf/html/0010ce.html.

Canada Transportation Act Review Panel: http://www.reviewcta-examenltc.gc.ca/english/pages/final/ch9e.htm#10.

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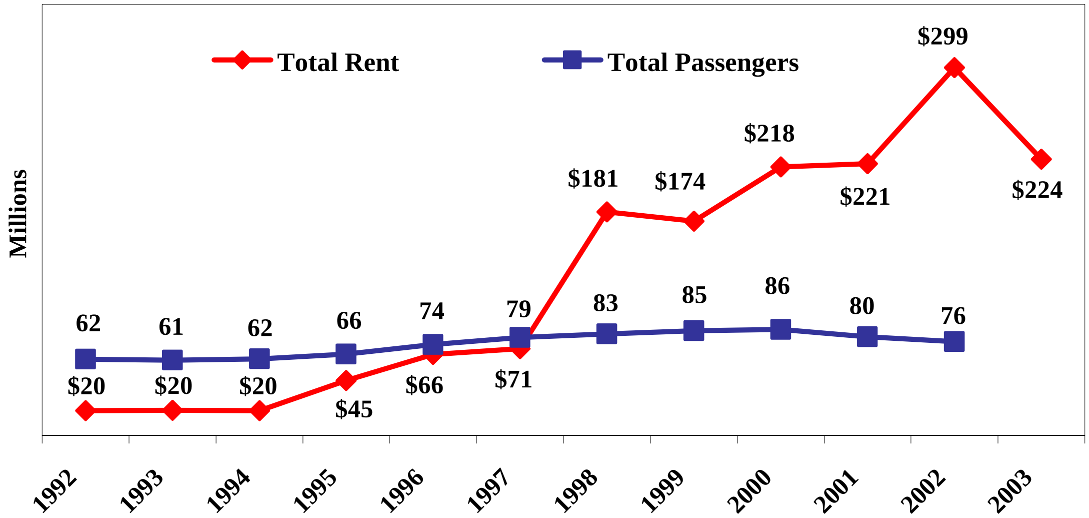
(1) Three NAS airports (Iqaluit, Yellowknife and Whitehorse) were divested to their respective territorial governments.

(2) The net annual rent revenue equals the total annual rent payments by some AAs minus the transfer subsidies to other AAs.

(3) Although these AAs received payments from TC in some post-transfer years, their rent payments were greater than the amounts they had received.

(4) Just over $7 million of the increase in 2006 over 2005, however, will consist of the repayment of deferred rent from 2003.

Figure 1: NAS Airport Authority Rent Payments, 1992-2003*

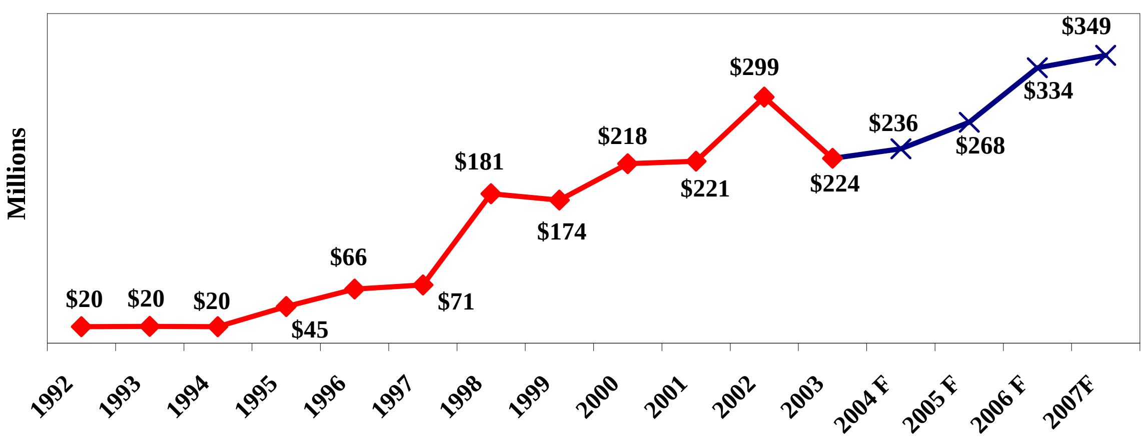


Source: Transport Canada, special data request.

* Five airports (Vancouver International, Calgary International, Edmonton International, and Montréal's Dorval and Mirabel) were transferred to four AAs in 1992, before the NAP was introduced. Two of these airports, Vancouver and Calgary, began to pay rent in 1992.

Note: A payment of $57 million in deferred rent was made in 2002.

Figure 2: NAS Airport Authority Rent Forecast, 2004-2007*



Source: Transport Canada, special data request.

* The forecast is sensitive to unexpected changes in passenger growth, airport authority decisions or other variables.

Note: A payment of $7 million in deferred rent is to be made in 2006.