EX30.15

TORONTO

REPORT FOR ACTION

City of Toronto Interests Regarding Airport Ownership

Date: January 9, 2018
To: Executive Committee
From: General Manager, Economic Development & Culture
Wards: All

SUMMARY

The Government of Canada continues to study potential ownership and governance changes to airports in the National Airports System (NAS), which includes Toronto Lester B. Pearson International Airport. NAS airports are currently owned by the federal government but are operated by local airport authorities which are governed by appropriate regulations including a long-term ground lease. Potential ownership and governance models vary, and each would require unique regulatory and policy regimes to balance the interests of all parties including governments, airport owners, users (airlines and passengers) and the overall public.

To date the Federal Government has not committed to a policy direction related to the ownership and governance of airports in the NAS and any other airport. It is anticipated that should changes in ownership occur, municipal governments may see impacts in terms of jurisdiction, economic development, infrastructure, community engagement and governance.

Given the uncertain federal policy direction and associated potential outcomes it is recommended that City Council request the Government of Canada consult with municipalities and the public before making any ownership changes to Canada's airports. This position aligns with the position of the Federation of Canadian Municipalities (FCM) of which the City is a member.

RECOMMENDATIONS

The General Manager, Economic Development and Culture recommends that:

1. City Council request the Government of Canada consult with municipal governments and the public before making any ownership changes to Canada's airports, aligned with the request of the Federation of Canadian Municipalities.

2. City Council forward this report to the Government of Canada, the Province of Ontario, the Region of Peel, the City of Mississauga, the Greater Toronto Airports Authority and the Federation of Canadian Municipalities.

FINANCIAL IMPACT

There are no financial implications resulting from the implementation of the recommendations in this report.

The Acting Chief Financial Officer has reviewed this report and agrees with the financial impact information.

DECISION HISTORY

On May 16, 2017, Executive Committee referred a Member Motion on "Opposing the Possible Privatization of Canada's Airports" to the City Manager to review and report back: http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2017.EX25.23

ISSUE BACKGROUND

In 2014, the Government of Canada initiated the statutory review of the *Canada Transportation Act* (CTA) with the goal of modernizing the national transportation system to continue to support economic growth. An independent six member panel (the CTA review panel) chaired by the Honourable David Emerson was initiated to provide advice on the CTA and also more broadly on the country's transportation legislative and policy framework. This included a specific request for the panel to consider ways to maintain and augment the "vitality of the Canadian aviation sector, air connectivity and Canada's ability to attract visitors and transiting travellers." The panel released its final report, *Pathways: Connecting Canada's Transportation System to the World* on February 25, 2016.

Among the CTA review panel's recommendations were for the Government of Canada to strengthen the National Airports System (NAS) (comprised of 26 large airports including Toronto Lester B. Pearson International Airport) by "moving within three-years to a share capital structure for the larger airports, with equity-based financing from large institutional investors, accompanied by legislation to enshrine the economic development mandate of airports and to protect commercial and national interests." This was recommended to improve the competitiveness of Canada's airports and to also raise significant amount of funds for the federal government to reinvest in infrastructure.

The CTA review panel noted that regardless of changes in ownership, changes would need to be made to the regime that governs Canada's airports including the rent structure, security fees, policy direction, and governance in order to improve the viability of the country's airports.

The CTA review and a subsequent Transport Canada public consultation process resulted in the federal government's *Transportation 2030* strategic plan, released in November 2016 which sets out a vision for the future of transportation in Canada. Bill C-49 was introduced in May 2017 to deliver on some of the Transportation 2030 measures. Neither Transportation 2030 nor Bill C-49 speak to the issue of airport ownership.

In fall 2016 it was widely reported in the media that the Government of Canada, through the Canada Development Investment Corporation (CDEV, a crown corporation), had hired Credit Suisse to review international practices and outline a range of ownership options (ranging from status quo to full for-profit status) of the eight busiest airports in Canada (including Toronto Lester B. Pearson International Airport) and 18 smaller airports. A subsequent contract was awarded to PricewaterhouseCoopers (PwC) to act as a commercial adviser for additional work regarding a new governance framework for airports.

In fall 2016, the Federal Government also announced the intention to create a Canada Infrastructure Bank. Formally established following the passage of Bill C-44 in June 2017, the Bank is mandated to leverage federal support to attract private sector and institutional investment to new revenue-generating infrastructure projects.

The CD Howe Institute recommended in February 2017 that the federal government move forward with the privatization of Canada's airports and that the sale of the eight busiest could raise between $7.2 and $16.6 billion. According to this study, Toronto Lester B. Pearson International Airport (Pearson) alone could be worth between $2 and $6 billion.

To date the federally commissioned consultant reports from Credit Suisse and PwC remain confidential and there has been no formal signal on any policy or program changes related to airport ownership from the Government of Canada. The Ministers of Transport and Finance have publically noted that the issue continues to be under study.

COMMENTS

Current Ownership and Governance Model

The airports in the NAS are currently owned by the federal government and are managed by local airport authorities under a long-term ground lease - for example, Pearson is owned by the federal government but managed by the Greater Toronto Airports Authority (GTAA). Local airport authorities operate on a not-for-profit basis as they are private corporations without share capital (most are incorporated federally under the Canada Not-for-profit Corporations Act). They are managed by an independent board of directors whose rules of operation are defined by the ground lease, applicable laws, regulations, and relevant policies. When airport lands are federally owned, they are exempt from municipal and provincial building and land use planning regimes (this does not include land owned by airports authorities that are bought outside of the federal ground lease).

The airport authority model does not apply to airports outside of the NAS, including Billy Bishop Toronto City Airport (BBTCA). BBTCA is now the ninth busiest airport in Canada however its ownership and governance structure differs in that it is not operated by an airport authority but by Ports Toronto, a federal port authority governed under the *Canada Marine Act*.

Airport authorities do not pay income tax nor dividends to the federal government but they must pay rent to the federal government for the ground lease and make payments in lieu of taxes (PILTs) to municipalities under the federal Payments in Lieu of Taxes Act and the provincial Assessment Act. In 2016 for example, the GTAA paid over $148 million in ground rent to the Government of Canada and $34.6 million in PILTs to municipalities including $188,990 to the City of Toronto for Pearson. As per Ontario Regulation 282/98 Toronto receives 0.57% of the $0.94/passenger in PILTs from Pearson. Any airport authority lands leased to non-exempt tenants are subject to property taxes.

Airport authorities must operate on a self-sustaining basis and receive no government subsidies. Any capital improvements must be financed by self-generated funding from various revenue sources and/or by debt (including bonds). At the end of the term for the ground lease (typically forty years plus with possible twenty year extensions) the property and all improvements are to revert to the federal government at no cost and on a fully debt free basis.

The current Canadian model for the NAS was created as part of the divestiture program begun at the end of the 1980's and carried on into the early 1990's with the first airport divestitures occurring in 1992. At the time of divestiture many of the airports were in need of major investment to upgrade, modernize, and expand infrastructure.

The divestiture program has achieved the federal government's goal of decentralization where airport improvements are determined based on local needs and priorities, and are paid for by local authorities and thus airport users. Local airport authorities also have flexibility in determining operational needs or development plans thus streamlining the decision making process.

The CTA Review panel noted that while the airport authority model resulted in more and better infrastructure (cumulative investments by airport authorities exceeded $19 billion to 2014), Canada's airports are now some of the costliest in the world. Some stakeholders such as airlines have noted that costs are driven by infrastructure needs as well as government imposed fees and taxes including rents. Beyond airport ownership changes, the CTA review panel also recommended that the Government of Canada review air transport user pay policies (such as government imposed fees, fuel taxes and rents) to improve cost competitiveness and sustainability.

Role of Airports

The role of airports has evolved from mere infrastructure providers facilitating domestic, cross-border and international traffic, to commercial enterprises with diversified activities. Non-aviation related activities – retail, catering, entertainment, parking and transportation services, rental of land and industrial buildings, etc, currently represent a significant share of income for many airports, sometimes more than 50%.

Airports are key players in the local economy supporting trade and tourism but they have evolved, in cases such as Pearson, into international hubs connecting the region to major centres around the globe becoming economic engines in their own right.

For example an economic impact study done in 2016 by Frontier Economics for the GTAA indicates that Pearson accounts for 49,000 direct jobs, and generates or facilitates a further 332,000 jobs across Ontario, contributing a GDP of $42 billion jobs. The study concludes that, based on projection on traffic growth, by 2030 it will generate or facilitate 542,000 jobs.

Toronto Pearson also anchors the Airport Employment Zone, which according to the GTAA is the second largest employment area in Canada, with 300,000 jobs which is more than the central business districts of Vancouver, Montreal or Calgary.

Competition between airports has also increased over time. To maintain and grow market share airports must offer competitive rates as well as incentives to attract new routes, and implement measures to improve aircraft traffic, passenger movement, security screening, baggage handling, customer experience (comfort, amenities, food and beverage), etc. The major Canadian airports also face competition from subsidized American airports near the southern border.

Evolving Ownership of Airports

At the time of divesture Canada was noted as a leader in commercializing airports. Since then a number of countries have moved forward with privatization, having implemented a number of ownership and governance models. Models in other parts of the world range from the complete transfer of airport infrastructure to private investors by sale or concession, to variations combining both private sector participation and government investment and control.

It is recognized that the term “privatization” may have several meanings. As described by Airports Council International (ACI), “privatization” is defined as participation of the private sector in the management, financing and/or ownership of airport infrastructure. This may include any or a combination of the following:

- Freehold: Full private sector ownership and management for an unlimited time.

- Listed companies: Airports owned by companies that are listed on stock exchanges and whose activities include the management of airports. The shares of these companies may be entirely in the hands of private entities and traded in the open market, or there may be a majority shareholder held by the public sector or government. These companies may own one or several airports.

- Concessions or leases: Instances where the public sector has given rights to private companies to operate and manage an airport or to take part in one or more of an airport's activities for a limited period of time. This model also includes build–operate–transfer (BOT) schemes in all their variations.

- Management contracts: Instances where the private sector obtains a fee for the management of all or parts of the airport or certain key aeronautical activities.

- Government-owned companies: The participation of government-owned companies in other airports as a private investment or for a fee (e.g., a 100% government-owned airport company acquires a concession contract for the management of another airport, be it in its home country or abroad).

According to the ACI there are currently more than 450 private or partially private airports around the world and this trend continues to grow. The dominant model for major airports takes the form of for-profit corporations with share capital. A number of these such as Aeroports de Paris and Beijing Capital International are listed on the stock exchange.

Increasingly large firms are being formed, such as Fraport, Vinci and Vantage Airport Group which hold several airports and operate in several countries. Recently Spain sold their airports and air navigation services leading to the creation of the largest group with combined traffic of 250 million passengers.

Others such as Heathrow Airport Holdings are fully private (closed capital). There is a vibrant and growing market for airports and institutional investors such as pension funds are very involved in this sector. Canadian firms are actively involved in such arrangements, including for London City Airport which is owned by a Canadian led consortium which includes OMERS and Ontario Teachers' Pension Plan.

According to the ACI approximately 41% of global passenger traffic flows through private airports and of the world's 100 busiest airports, 46% have some form of private sector participation. The largest area of private sector participation is Europe with those airports handling 75% of passenger traffic through the region.

Concession contracts (41%) represent the most common private sector participation model for airports, followed by freeholds (24%), listed airports (23%) and management contracts (8%).

Private equity flows to many of the world's busiest airports. These airports are nexuses in the air transport value chain and gateways to major destinations and centres of commerce. Eight of the world's top 20 and 15 of the top 50 airports are managed by airport companies and airport groups traded on stock exchanges. Smaller airports tend to be owned by the public sector.

The experience of privatization in other jurisdictions indicates that private operators generally increase the amount of capital investments and seek to maximize non-aeronautic revenues and that the cost impact to consumers is inconclusive.

Stakeholders are concerned about the potential for increased fees on passengers and airlines and the burden this may add on the cost of travel, as well as the preference to retain ownership of critical assets in the public domain.

Should privatization occur and depending on the model chosen, a regulatory regime would need to be established in order to strike a proper balance between the interest of shareholders, airport users (passengers and air carriers), and the broader public. This includes the need to establish governing bodies, regulations, and appropriate approval processes such as for price increases. Regulations will need to be structured to address stakeholder concerns and to prevent any abuse of dominant market position while avoiding burdens that may limit agility in the deployment of required infrastructure or creating a disincentive to investment by limiting revenues and return on capital.

Municipal Interests

Should the Federal government move forward with changes to airport governance and ownership (for airport authorities or other types of airport models), there may be a number of impacts to municipal governments. The extent and magnitude of these impacts would vary depending on the model undertaken and the regulatory regime that is put into place. These include:

Jurisdictional issues - as airports are currently under federal jurisdiction and federally owned they are generally exempt from the municipal land use planning and property tax regimes. Changes to ownership and/or governance may impact municipal jurisdiction. .

Economic development - as noted earlier, airports are critical to local economies and it is important that they not only have up to date infrastructure but are cost competitive to users. Such challenges can be expected regardless of ownership model. Ongoing airport/municipal collaboration is also necessary to ensure alignment in strategic directions including with international trade, foreign-direct investment, and aerospace sector development initiatives.

Shared infrastructure priorities - as key participants in local economies, airports and municipalities have a shared interest in ensuring seamless connections for people and goods arriving to/leaving from the airport. Various airport ownership and governance models may allow for access to new sources of funding and financing which could be used for investments in infrastructure.

Community engagement - airports generally engage communities on a variety of topics including strategic planning, noise and environmental impacts and customer service. For example, the GTAA currently has a Consultative Committee, a Community Environment & Noise Advisory Committee (CNEAC) and a Consultative Committee on Taxis and Limousines. The expectation of and level of community engagement by airports may vary depending on the ownership and governance model in place, including the regulatory regime imposed by governments.

Governance and local representation - under the current model, municipalities generally nominate members to serve on the airport authority board of directors. In addition, municipalities may nominate representatives to other airport authority committees and working groups. For example, with respect to the GTAA, the City of Toronto nominates: a public member to the Board of Directors; two Members of Council and a public member to the GTAA Consultative Committee and; two public members and one Member of Council to the GTAA CNEAC. Such arrangements allow for a formalized role in decision making. The continuation of such a model depends on the ownership and governance model pursued by the Government of Canada.

Municipal and Stakeholder Perspectives

A number of municipalities and airport authorities have expressed a wide variety of opinions regarding potential changes to airport ownership. The airport authorities of Vancouver, Calgary and Ottawa have come out opposed to for-profit privatization as has organized labour, and Canada's major airlines including the National Airlines Council of Canada which is comprised of Air Canada, Air Transat, Jazz and WestJet. The Province of Alberta and the cities of Victoria, Vancouver, Richmond, Calgary and Montreal have also voiced opposition. The primary reasons for opposition include support for the existing airport authority model, potential cost increases to airlines and passengers and the potential loss of local representation in terms of governance.

The GTAA has not taken a formal position however has noted that any changes should support Pearson's move to 'global hub' status and support investments in transit, while keeping costs competitive.

In September 2017, the Federation of Canadian Municipalities passed a resolution (sponsored by the Capital Region District, British Columbia) requesting that the Government of Canada consult with municipal governments and other stakeholders before making any changes to airport ownership. This has subsequently been endorsed by the City of Mississauga and the Region of Peel which is where Pearson is located. The Region of Peel is expected to consider further information regarding airport privatization at its meeting in January 2018.

Conclusion

The Government of Canada has a number of levers to improve the viability and competitiveness of Canada's airports, including changes to airport ownership. As the ownership models vary, they will require specific regulatory and policy regimes which ensure that the outcomes and impacts are balanced among owners, users and the overall public. Given the uncertain federal policy direction, the multitude of potential outcomes and varied municipal and stakeholder opinions including the positions of FCM, the City of Mississauga and the Region of Peel, it is recommended that City Council request the Government of Canada consult with municipalities should it proceed with any ownership changes to Canada's airports.

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SIGNATURE

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