



## GENERAL MANAGER'S REPORT

13 October 2009

<b>GM7</b>	<b>AIRPORT BUSINESS PLAN</b>	<b>FILE: 183</b>	<b>KEO</b>	<b>{ Folio No. * }</b>
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### SUMMARY:

Reporting on the investigations into the long term viability of the Kempsey Airport under a number of development scenarios.

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### DESCRIPTION:

#### Financial Analysis of Business Costs

Council has for a number of years been looking at the potential for attracting business to the airport as a mechanism for minimising the cost of retaining the asset to the community and as a potential driver of economic development. While there has been work done on layouts and discussions on possible users, there has not been a comprehensive assessment of the costs and benefits of the proposal. Similarly, there has not been any asset checking to determine the current condition of the infrastructure and the need for ongoing renewals. A financial assessment of the airport and the impacts of various options to upgrade and expand the facility have been undertaken.

The following are the costs related to development of the airport. The costs have been staged, as there is potential to release around ten lots in a stage before further extensions are required. Even with staging, there are significant up front costs involved to provide the sewerage and the water to the levels that will be required to meet the future development needs.

#### Airport Concept Plan - Establishment Costs 2009 figures

	Rate	Stage 1	Stage 2	Stage 3	Stage 4	Total Cost
Taxiway	\$75.00	270,000	\$202,500	\$337,500	405,000	<b>1,215,000</b>
Lighting (Taxiway)	\$34.00	13,600	\$10,200	\$17,000	23,800	<b>64,600</b>
Apron	\$75.00	375,000	\$375,000	\$375,000	375,000	<b>1,500,000</b>
Lighting (Apron)		10,000	\$10,000	\$10,000	10,000	<b>40,000</b>
Road	\$75.00	121,500	\$99,000	\$90,000	58,500	<b>369,000</b>
Street Lighting	\$5,000.00	25,000	\$25,000	\$20,000	15,000	<b>85,000</b>
Electrical Supply	\$440.00	110,000	\$114,400	\$51,000	22,500	<b>297,900</b>
Water	\$58.33	69,996	\$15,166	\$19,832	8,750	<b>113,744</b>
Sewerage		250,000	\$20,000	\$20,000	20,000	<b>310,000</b>
Stormwater	\$144.00	57,600	\$14,400	\$57,600	14,400	<b>144,000</b>

	<b>Rate</b>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>Stage 4</b>	<b>Total Cost</b>
Fencing	\$134.00	30,150	\$30,150	\$30,150	30,150	<b>120,600</b>
Water Tank		100,000				<b>100,000</b>
<b>Total Costs</b>		<b>1,432,846</b>	<b>\$915,816</b>	<b>\$1,028,082</b>	<b>983,100</b>	<b>4,459,844</b>

While the above figures indicate a sizeable investment, this needs to be offset against the potential value of the income that could be generated if the infrastructure was put in place. Previous valuations have indicated that the land serviced by the airport could be leased at a rate of \$3.60 per square metre. Assessment of the saleability of the land would indicate that up front payments for a 99 year lease are likely to be in the range of \$50,000. A review of the 11 hectare site indicates that there is likely to be 60 or less individual hangar sized lots available. Based on these numbers, there is the potential to raise \$3 million. The above infrastructure will not have a 99 year life, as such the annualised cost of the capital for the equivalent 99 year period will range from \$6.6 million to \$6.8 million.

Council does not have the initial funds to provide such capital upgrades and this and other councils experiences would indicate that the chance of gaining grant funds are limited. As such there would be a capital investment cost in loans and their repayment. While the repayment of the loans, until such time as capital costs could be recouped, may cause concerns with Council's funding, at this stage it is the cost of the interest that is a valid cost against the revenue from the sale of the hanger sites. The cost of these loan funds, using the staged development is \$3.1 million over the 20 year period assessed.

Now the operations of the facility need to be considered. The above figures do not include the cost of the continual operations and renewal of the airstrip that currently exists. Ongoing revenue is minimal, at \$42,000 per annum and this will drop further with the sale of 99 year leases to current tenants, giving an ongoing base income of around \$22,000 per annum. With the attraction of new tenants, it would be expected that landing fees would increase. A ten percent compounding increase has been factored in over the time that the development would be filled up. Even with such a high target, the income would still be relatively insignificant, going from \$7,300 to around \$35,000.

Operating expenses consist of two costs, the ongoing minor maintenance and operating costs, and the costs of renewing the infrastructure. Allowing for these costs the average annual operating expenditure is in estimated to be around \$376,000. This may be lowered slightly by lower than optimal intervention levels, but such an approach would also potentially lead to higher maintenance costs, such as Council is soon likely to incur as a result of the existing strip not having been resealed since around 1993.

Based on the average from the 20 year calculated figures, the cost to service the purchasers of the 99 year leases will be around \$30million, or \$312,000 per year.

As can be seen from the above, the business case, based on the likely sale pricing of the land is not favourable. From this point an assessment of the potential to lower costs by deferring infrastructure upgrades was undertaken. This did not materially affect the results. A review of the results utilising a process of renting

the hangers at the yearly rates we currently receive, which have been reviewed and are at the higher end of similar fees, showed that this would be a less cost effective way of undertaking the development, due to the higher interest costs involved.

### **Break Even Cost Analysis**

A further assessment of the project, based on determining the breakeven costing for the development has shown that the Council would need to recoup around \$24 per square metre to cover the costs of the development and running of the airport. In comparison, Bankstown Airport had valuations on the rental of land at the airport as being around \$27 in 2006. Unless the costs have doubled, the cost advantage of moving aircraft maintenance to this area is minimal. In addition, the Bankstown Airports web site only identifies ten aircraft maintenance businesses as being located there. Considering the number of councils that are currently trying to actively entice those businesses to relocate to regional airports, it would be difficult to gain any large payments of rental from these companies.

### **Demand and Supply Assessment**

This moves the assessment onto the demand for land attached to airports. A review of air services in Australia found that the number of communities with a regional passenger transport service dropped from 405, in 1984, to 138 in 2008. This means that nationally there are 267 airports that now are in the similar situation to Kempsey. In addition many of the airports with regional passenger transport are looking to develop. Tamworth invested \$16million in 1993 and states they have 200 hectares available to lease. A private operator has just announced a \$15million airpark at Goulburn covering 72 hectares in addition to Goulburn Airport, which is being sold off by the Council to another airport corporation to be redeveloped, of 63 hectares. It is interesting to note that the Royal Australian Navy was looking to sell the Schofield Airport in 2008 (for housing) and this did not eventuate. The airstrip sits disused, indicating that it is unlikely that another airport will be developed within the Sydney basin, as the demand for the site to continue airport operations was obviously not sufficient to encourage any private operator to re-establish this airstrip. There would still be the potential to redevelop this airport. This would create a significant supply of airport land, in addition to all of the airstrips that are no longer used for regional passenger transport.

Against this supply, Bankstown Airport quotes that it has approximately 180 businesses. But of these, only 10 are listed as aircraft maintenance on the airports own web site as well as 17 as training schools and 23 as charter operators. Of the last two there is significant overlap. The airport states its site area at 313 hectares. But of this, only 12 hectares is leased to airside tenants. Most of the associated airport related companies are not located on the airport land and as such may not be facing the same cost pressures of leasing that are claimed to be forcing people out of Bankstown Airport. Their forecasts are to develop 20 new hangers and expand the freight area by 7-8 hectares. Their future plans show that they assess around 160 hectares currently available, but of this, 45 hectares is grass tie down areas and a further 70 hectares is apron area. There is a clear future focus on specialised passenger flights and freight, these demands may result in increased costs due to demand on other users. The first likely group to be dislocated is seen to be the aircraft parking, for which Kempsey is not well located as a substitute due to its distance from Sydney.

Bankstown Airport's business movements out could easily be catered for by the developments listed above, let alone the other regional players such as Orange,

Bathurst, Taree, etc. This is seen as a very competitive market when looking at an overview of what is happening throughout the state.

### **Relative Advantage Assessment**

The business case has been staged on attracting three small businesses per year. No larger businesses have been identified that could be targeted for Kempsey to have a natural competitive advantage unless the Council is prepared to divert a significant amount of additional resources to the airport. The current aviation market consists of:

- **Passenger flights:** These are the regular passenger flights and have been consolidating into the larger regional centres. This consolidation has been happening over a large period of time and is considered unlikely to change. The consolidation is seen as being driven by the costs of using airports, such as Sydney, where demand for landing slots makes the use of larger planes the most effective option. It is also seen as being driven by the efficiency of larger airplanes changing the type of aircraft generally used.
- **Aircraft Maintenance:** These can be split into two groups, maintenance on larger passenger flights and on small charter flights and private planes. The first group is seen as unlikely to find a commercial advantage in the Kempsey airport as it would necessitate the aircraft being flown from a location without passengers and then returned into service. This would involve the potential for significant landing fees as a result. It is considered that the medium size aircraft would locate out of a base where a regional passenger service is located to minimise these costs. Kempsey would not have a cost advantage over land at those locations. Servicing for charter flights would have a similar problem with landing fees, as an example each flight of a Dash 8 would incur \$269 landing fee on coming into Kempsey and a \$546 cost on returning to Bankstown. While this would be lower for regional airports, but so to is the cost of establishing near where a number of charter operators are located. No charter operators are located at Kempsey, but there is the possibility that operators may be pushed out of Port Macquarie and Coffs Harbour.
- **Charter Operators:** It is considered that there would be an advantage to charter operators locating where the passengers are unless there was a significant cost advantage. Disadvantages would be that the craft would incur additional landing fees when flying into the location of the passengers and the additional costs of flying from the passenger location to and from the base. From the financial assessment the Council would not be able provide this competitive advantage without a significant subsidy being offered, beyond the current subsidy.
- **Private Owners:** Due to the location of the Kempsey Airport it is not seen as likely that there is an advantage to owners of private aircraft from outside the region. There may be some relocations from Port Macquarie and Coffs Harbour possible, but significant movement is not likely at the present time, considering that at Port Macquarie, for example, private users only pay \$473 per annum for rental. In addition there are only 17 sites at Port Macquarie, which only provided minimal potential demand. In addition there are plans for the addition of a further ten sites at the airport for general aviation.
- **Flight Training:** The potential for flight training schools has been mooted on a number of occasions. At this stage no firm opportunities exist for this

use, with the major air companies being established in various locations around Australia and the world.

To provide a comparison of the current cost structures and see if there is a pricing advantage in flying into and out of Kempsey airport, a review of a number of airports has been undertaken. The following table summarises the information gained.

<b>Airport</b>	<b>Landing Fee (per Tonne)</b>	<b>Hanger Rental (m2)</b>	<b>Plane Parking (per annum)</b>
Sydney	\$3.78		
Bankstown	\$14.76	\$27.00	\$4,171
Taree	\$7.00	\$3.80	\$236
Port Macquarie	\$8.00	\$7.70	n/a
Coffs Harbour	\$6.27	\$3.95	\$0
Ballina	\$7.27	\$6.50	\$4,745
Bathurst	\$12.73	\$3.30	\$320
Armidale	\$7.27	\$2.75	\$320
<b>Kempsey</b>	<b>\$7.27</b>	<b>\$3.60</b>	<b>\$350</b>

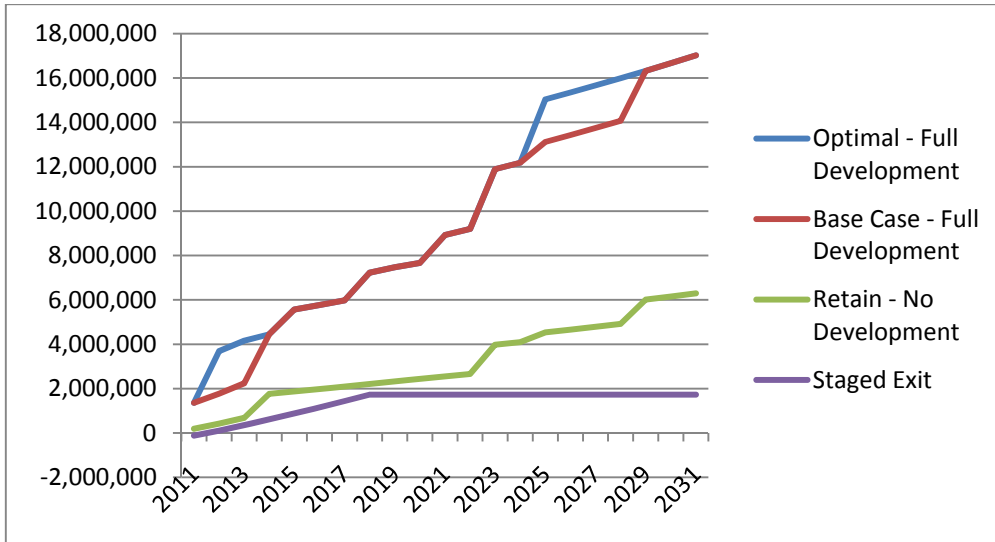
The above information shows that Kempsey does not have a current price advantage. In addition there is not sufficient financial funds to support a heavier subsidy and even the first round of infrastructure renewals, that are technically past due, since the Council took ownership of the Airport in 1993.

### **Current Situation Assessment**

It has been identified that the pavement of the airport is heavily oxidised and has significant crocodile cracking. If these matters are not dealt with in the near term future the Council will face more significant costs in repairing the airport surface. While this could be allowed to deteriorate, within a relatively short period of time the surface will start to become unsafe for aeronautical use through stripping, potholing and cracking.

### **Summary of Outcomes of Business Case Assessment**

The following chart shows the accumulated costs for the main options. As can be seen the deferral of capital intervals only defers the costs over the 20 year time period.



The current operations have a realistic cost to the community of \$330,000 per annum to sustain. Development of the area to attract increased usage, if successful, would reduce the average annual costs to \$312,000. However, the capital costs of this savings equates to \$68,500, leading to an annual cost to the community of \$380,500, more than the cost of not attracting the businesses.

It is difficult to see that Kempsey has advantages that would allow it to move above the competition that is currently in the marketplace. Kempsey does not have materially lower landing or land costs. By not currently having a base of other aircraft it does not have economies of scope to leverage off, leaving Kempsey in a less favourable position than areas that have other services in place.

The demand for groups to move out of Bankstown is not seen as high, based on the number of aeronautical businesses currently showing as located in that aerodrome. In addition Council will have to compete against not only larger councils, but also private investment consortiums in trying to attract what companies may be able to be leveraged out of Sydney.

### Alternative Options

From the perspective of opportunity costs, council needs to consider whether this is the best use of funds. It would not be possible to convert the entire real cost of the Airport into other economic development areas, as the real cost is not currently fully funded, however it is considered that the funding provided by conversion of the airport land into rural residential land would allow funding to be raised to establish, in turn an industrial park. The current cost of the airport operations could be used to cover the cost of loan funding the rural residential development. Once sufficient sales were completed Council could develop an industrial estate in a suitable location to attract, service and supply industries out of Port Macquarie to compete as a service centre for the growing populations in the high demand coastal residential areas.

Council would need to undertake a staged approach to the withdrawal of the airport, including potentially working with the current commercial tenant to assist in their relocation.

### **RECOMMENDATION IMPLICATIONS:**

- **Environmental**

*No significant issues are seen with the conversion of the land to rural residential land.*

- **Social**

*The future costs of providing the asset for what may only be 70 to 100 jobs is significant and may not be the best option for funding as it is moving into a highly competitive market with low demand. This makes the investment a risky investment and should the investment decision not be rewarded the community will have to cover the costs. The additional costs over what is currently shown in the Council's budgets are not funded and will have to be funded through rate increases or cuts to other services.*

*The facility is currently used by a small number of people for recreational purposes. This will impact negatively on that group.*

*The community will not have an airport for the air ambulance to land on. The community will have to rely on helicopter rescue services, which have alternative sites. As there is a helipad at the Kempsey Hospital, this is seen as acceptable taking into account the cost of retaining the airstrip solely for that purpose.*

- **Economic (Financial)**

*Council does not currently have sufficient resources to undertake a major development without the use of loans. There is no capacity to support the loan repayment from the airport development. Further future funding will be required to maintain the airport.*

- **Policy or Statutory**

*Nil.*

**RECOMMENDATION:**

**That Council undertake a staged withdrawal from providing an airport and develop a business case for development of the land that will allow for future economic development opportunities.**

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**D L Rawlings**  
**GENERAL MANAGER**