

Fuelling the city's economy with direct international flights

Recommendations of the Board of Trade of Metropolitan Montreal as part of consultations by the Commission sur le développement économique et urbain et l'habitation



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Introduction: a serious issue for the Montréal business community

The Board of Trade of Metropolitan Montreal has over 7,000 members. Its mission is to be the voice of Montréal's business community and to promote the city's prosperity. It is involved in key areas of economic development, promoting a philosophy of action based on engagement, credibility, proactivity, collaboration and innovation. The Board of Trade also offers a range of specialized services for individuals and businesses of all sizes to support them in their growth at home and abroad. This mission is what prompted the Board of Trade to submit this brief as part of public consultations conducted by the Commission sur le développement économique et urbain et l'habitation (Committee on Economic and Urban Development and Housing) on increasing the number of direct international flights.

The quality of air service has a major impact on the economic vitality of cities. Cities have growing economic clout in the world economy and play the role of regional drivers. A city's ability to insert itself within international value chains depends on a variety of factors, such as labour training, business innovation and the quality of links with major global economic centres.

The impact on the tourism industry is obvious. According to Statistics Canada, in 2012 Greater Montréal welcomed 1,969,027 international tourists, a large portion of whom arrived by plane. These tourists account for over 50% of tourism spending, or an estimated \$2.4 billion. The quality of air service also has an impact on the Quebec tourism industry as a whole since Montréal is one of the gateways for international tourists visiting the province. Plus, air service has a major influence on the city's appeal for international conferences.

While the impact of air transportation on the tourism industry seems clear, its influence on other economic sectors is just as significant. For the business community, access to direct flights represents:

- Savings in time and money (transit taxes) for travel;
- An incentive for Quebec companies to internationalize;
- Easier access to new markets;
- An asset for attracting companies with international activities and their national or regional head offices.

According to a survey conducted on behalf of the International Air Transport Association (IATA), the absence of quality service is a factor considered by 18% of companies in their investment decisions. It is a consideration that is particularly important for high-tech sectors. Additionally, around 28% of companies surveyed see a significant correlation between innovation and investment in research and development and the quality of a region's air service.

This brief provides an overview of the Montréal context, addressing the quality of service, its strengths, challenges and opportunities to tap into. It then presents a strategy for increasing the number of direct international flights by acting on factors related to cost, demand and Montréal's attractiveness. The Board of Trade's brief includes recommendations for executing this strategy.

Out of concern for transparency, the Board of Trade would like to point out that it was involved in the creation of Aéroports de Montréal (ADM). As part of the organization's governance rules, the Board of Trade has the power to recommend candidates for three of the seats on the ADM board of directors. However, ADM governance is independent from the Board of Trade, and this brief commits only the Board of Trade.

1. The Montréal context

1.1 Quality service in spite of a difficult situation for the airline industry

According to a recent study by KPMG-SECOR, **Montréal is well served when it comes to international flights**. The study shows that, thanks to Aéroports de Montréal's (ADM) efforts to convince air carriers, air service has developed considerably over the past 10 years, growing from 30 international destinations to 75, representing an increase of 150%. During the same period, the annual growth rate in passengers was 4.6% and for international travellers was 9.8%. Based on a list of the 123 most influential cities in the world, the study indicates that Montréal is ranked second in Canada and fifth in North America for direct destinations.

This improvement in the quality of air service in Montréal is even more remarkable given that the air transportation industry is emerging from a particularly difficult decade. The sector suffered net losses of \$68 billion from 2000 to 2009 inclusively. During this period, only the years 2000, 2006 and 2007 were profitable. Many airlines, such as Air Canada, Delta, Frontier, Northwest, US Airways and United Airways, had to be placed under the protection of the *Bankruptcy and Insolvency Act* or the *Companies' Creditors Arrangement Act*.¹

Today the air travel industry is fiercely competitive and profit margins are slim. According to an IATA study, the average profit margin for airlines was around 1% in 2012. This explains the concentration of flights in airports used as hubs. A company "groups" passengers from several cities in hubs to reduce costs and increase the profitability of long-haul flights. **Clearly, airlines have to manage their risk and focus on links with likely or demonstrated profitability in the short or near-medium term.**

While the findings of the KPMG-SECOR study are encouraging, we cannot ignore the issue of perception. The Board of Trade hears regularly from members of the business community disappointed by the lack of direct air service to destinations that are important for their business. These concerns raise two underlying questions. First, are there enough business or leisure travellers in the metropolitan area and in the desired destinations to economically justify these links? Second, could Montréal-Trudeau resurrect its status as a hub, filling these flights with travellers in transit, which would justify their existence? These two questions are central to these deliberations.

1.2 Strategic positioning for Montréal

Montréal is currently positioned as a hub between North America and Europe, the Middle East and North Africa. This situation is directly tied to the city's demographics. The fact that the population shares cultural affinities with Europe, particularly France, generates significant air traffic between Montréal and the Old Continent. This is in addition to the fact that large numbers of local immigrants hail from Europe (e.g., France, Italy and Greece) as well as Maghreb and the Middle East (e.g., Morocco, Lebanon and Tunisia). In short, Montréal's population and its cultural affinities are an asset for the airport's positioning by constituting a major source of traffic to these destinations.

The Board of Trade believes that it is strategically important to maintain and reinforce Montréal's positioning as a hub between North America and Europe, the Middle East and North Africa. This positioning, already adopted by ADM and Air Canada, is based on the presence of solid demand, and the Board of Trade supports this business strategy.

1. <http://veilletourisme.ca/2010/02/17/une-decennie-horribilis-pour-l%E2%80%99industrie-aerienne/>

With the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union coming into effect soon, direct flights between Montréal and European cities will be a major asset for the business community. In fact, according to federal government data, bilateral trade between Canada and European Union countries should increase by 20%. **This is an opportunity to expand the service period for routes such as Rome, Barcelona, Lyon and Athens, which are currently seasonal.**

Furthermore, the U.S. is currently negotiating an agreement similar to the one between Canada and the European Union. If this agreement is signed, Canada will have several years' lead in positioning itself on the European market. This applies not only to exporters, but also to the transportation sector. As such, Greater Montréal has the potential to position itself as a continental gateway between North America and Europe. This is why the position currently held by the Montréal-Trudeau Airport with respect to the European market is a strategic asset, and one that is important to reinforce.

To strengthen this positioning, **the Board of Trade believes that it would be of benefit to increase the number of flights to Western U.S. cities.** That would enable Montréal to position itself as a transit airport between Western U.S. cities and Europe. More travellers in transit means more revenue for ADM, putting it in a better financial position to attract new flights.

Montréal's positioning with respect to the Middle East and Northern Africa is also an asset because these regions are expected to see significant economic growth in the coming years. According to IHS Global Insight, the Middle East (3.8%) and Africa (4.6%) will see their GDP rise faster than the world average (3.3%) over the next 20 years.

In short, the Board of Trade believes that by concentrating on the niches of Europe, Africa and the Middle East, Montréal-Trudeau Airport can aim to become the second most important **hub in the French-speaking world**, after Paris.

1.3 A few challenges: China and South America

In spite of its enviable position, Montréal's air service faces a few major challenges, the first of which is the absence of direct flights to Asia and South America. Without calling into question the current positioning described above, the Board of Trade believes it is necessary to establish direct flights to these two continents, because they are regions where air traffic will see intensive growth in the coming years due to sustained economic development. According to IATA, the Asia-Pacific region should see an increase of up to 300 million passengers between 2013 and 2017.²

Specifically, we need a direct flight to China because of its economic weight on the world stage and the extent of commercial ties Montréal businesses have with that country. Furthermore, according to a KPMG-SECOR study, there is enough demand to establish a profitable flight to Beijing. However, efforts have been unsuccessful, because there is no time slot available at Beijing Capital International Airport.

The new link with Panama City's airport, a major hub in Latin America, is excellent news for the business community because it is one more step toward a direct link with South America. Direct flights to Brazil or Chile, two major economic partners, would be to our advantage. Plus, we should remember that 45 direct flights are seasonal, limiting their usefulness for the business community, whose activities are generally not highly seasonal.

2. <http://www.iata.org/pressroom/pr/Documents/French-PR-2013-12-10-01.pdf>

1.4 A new strategy possible with the Dreamliner

As noted earlier, establishing air service is first and foremost a business decision for an airline. In a context where the airline industry is fiercely competitive and profit margins are slim, airports that already have dense air traffic are naturally preferable. Montréal and its business community would have little to gain from air service with uncertain long-term profitability, the sustainability of which would be threatened. **The appropriate strategy is therefore to convince airlines of the profitability of the air service the community wants.**

However, **flights with clear profitability have already been established.** This means that more sustained efforts will be needed to convince air carriers to choose Montréal over other airports for establishing new direct flights. According to KPMG-SECOR, there remain only four destinations that would be profitable year-round: Beijing, San Diego, San Jose (Costa Rica) and Beirut. No satisfactory landing slot is available in Beijing, and Beirut cannot be served for reasons of national security.

While gaining new direct flights is unlikely for the time being, the situation could change soon, and new opportunities could emerge. With aircraft such as the Dreamliner coming into service, which lowers the minimum traffic required for certain destinations, new flights to major cities could be profitable. For example, with the Dreamliner, a destination such as Beijing or Sao Paulo could be profitable with a minimum annual volume of 29,400 passengers, compared with 41,800 for a B777-300ER aircraft. Furthermore, currently seasonal routes (e.g.: Rome, Barcelona, Lyon and Athens) could become profitable year-round.

Essentially, once these aircraft are in operation, new opportunities for flights will emerge, and it is important that Montréal position itself now to win them. Otherwise, the city could lose these new flights to other airports. **To tackle the challenge, the Board of Trade believes that it is important to establish a concerted strategy to support ADM in its efforts to attract new air service, taking full advantage of the possibilities of the latest aircraft.**

2. Our recommended strategy

2.1 Where to intervene

Given that establishing air service is primarily a business decision for airlines, the appropriate strategy is to convince them of the profitability of the flights we want. When an airline is evaluating the possibility of establishing service, it bases its decision on a range of factors that we can act on through leverage.

The two main types of factors that external players such as the Board of Trade or the Ville de Montréal can influence are **cost** and **demand**.

Factors related to **cost** include taxes and fees that affect airports and airlines and that are ultimately reflected in the price paid by passengers. These costs particularly influence the competitiveness of airports and their ability to attract airlines and establish flights.

Having sufficient **demand** for a direct flight is a fundamental to determining its profitability. This includes local traffic from the community directly served by the airport and connecting travellers. The minimum demand required depends on the abovementioned cost-related factors.

2.2 Reduce costs to make ADM more competitive

To influence cost-related factors and convince airlines to establish new flights, ADM offers highly competitive financial incentives. It discounts landing fees from 100% to 25% during the first three years of new direct flights and matches the airline's investment to promote the new destination (50-50).

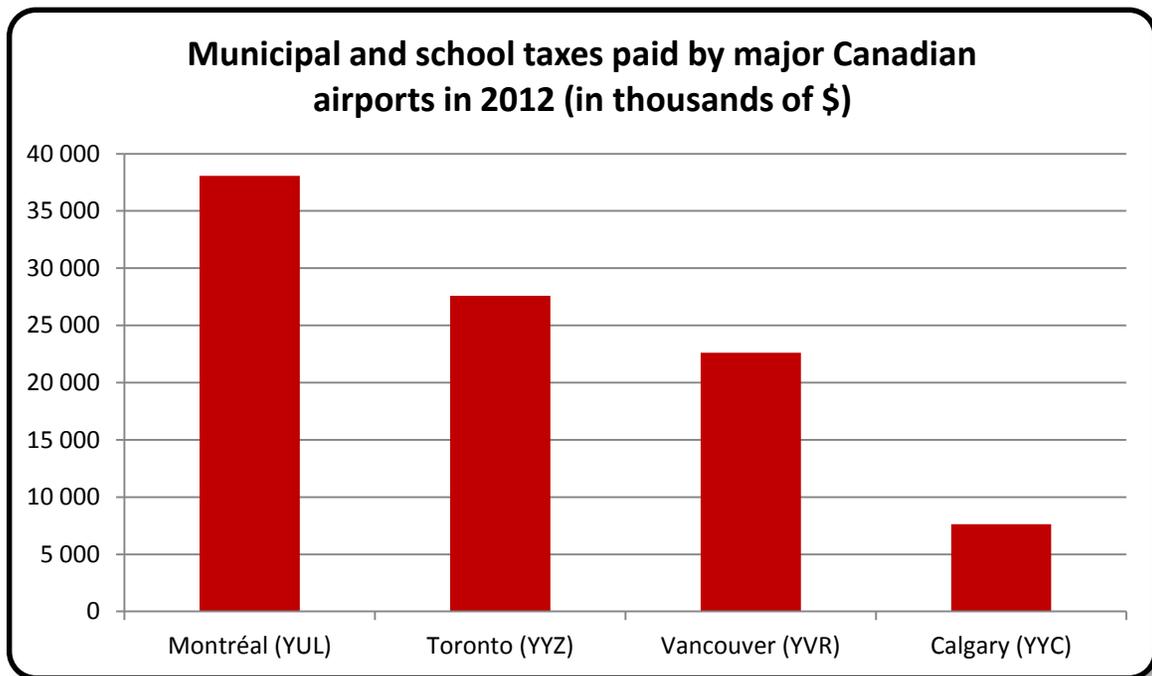
Given that in 2011 the World Economic Forum found that Canada ranked 125th among 139 countries for taxes collected on flights and airport fees, Montréal-Trudeau Airport is at a disadvantage with respect to airports in other countries. According to the 2012 report by the Standing Senate Committee on Transport and Communications, a Canadian flight between two major cities can cost at least twice as much as a comparable flight in the U.S. The report also indicated that passengers pay a supplement of around 60% to 75% for fees and taxes, which is only 10% and 18% in the U.S. **In short, the ADM's financial incentives are merely compensating for an unfavourable business environment.**

Municipal costs

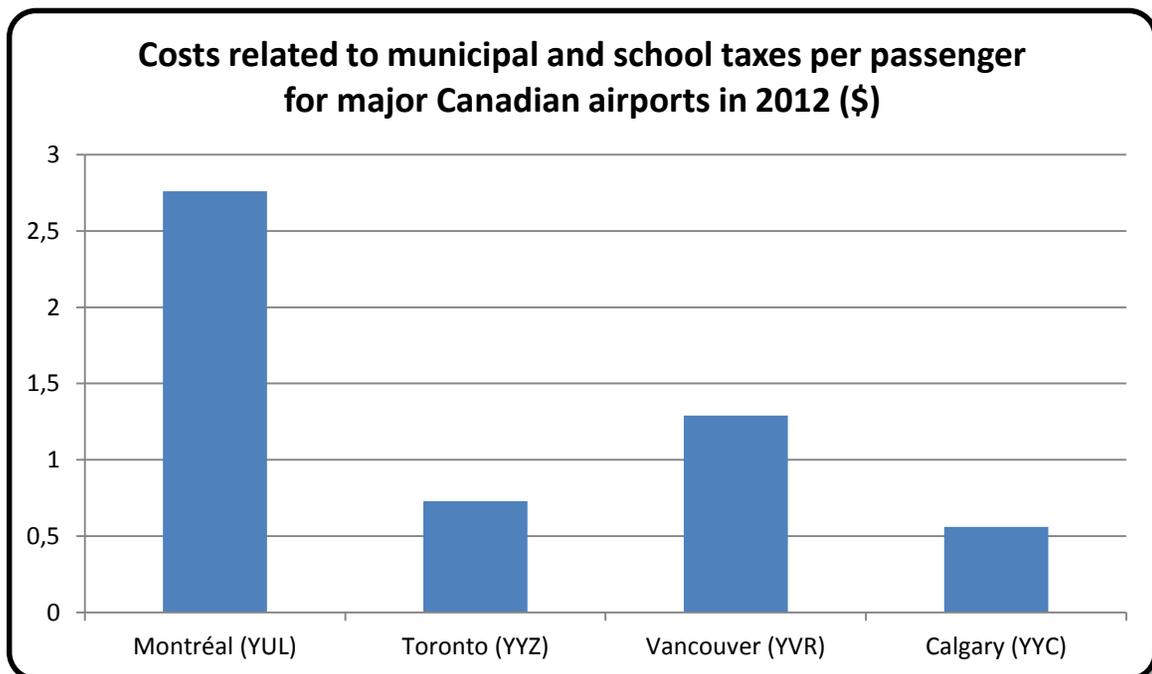
The fact that ADM pays more **municipal and school taxes** than other major Canadian airports directly affects its competitiveness in the country. As shown in the graph below, ADM paid \$38,066,000 in municipal and school taxes in 2012. Compared with other main Canadian airports, ADM paid:

- 38% more than Pearson International Airport in Toronto;
- 68% more than Vancouver International Airport;
- 398% more than Calgary International Airport.

The gap is even wider with American airports, which are generally owned by cities or states and do not pay municipal taxes.



As shown in the second table, this amount results in an additional cost of \$2.76 per passenger, compared with \$0.73 for Toronto, \$0.56 for Calgary and \$1.29 for Vancouver.



In light of this data and to make Montréal-Trudeau Airport more competitive and attractive to airlines, the Board of Trade believes that municipal taxes collected from ADM should be reduced.

1. The Board of Trade recommends that the Ville de Montréal show leadership and reduce the municipal taxes collected from ADM.

Given the amount collected in taxes from ADM and the budget constraints the Ville de Montréal is facing due to the current legislative framework, **the Board of Trade would support any intervention by the Ville de Montréal with the Government of Quebec to ensure that the next financial agreement and the new law on metropolitan status increase the resources available to Montréal.** Montréal-Trudeau Airport is a strategic infrastructure for the entire province, and as such, it is not solely up to Montrealers to absorb the cost of increasing the airport's competitiveness.

Federal costs

In addition to municipal taxes, there are a number of major costs affecting competitiveness and ticket prices that fall within the federal government's purview. Every year, ADM pays 12% of its revenue to the federal government in the form of rent. Since its privatization in 1992, ADM will have paid a total of \$364 million in rent to the federal government, in addition to sparing the government \$2.7 billion in capital expenditures. On top of these costs, there are other taxes and fees that limit the competitiveness of Canadian airports, such as the air travellers security charge and NAV CANADA service fees.

After demonstrating its leadership by reducing municipal taxes collected from ADM, the Ville de Montréal will be in a position to lead a concerted effort to call on the federal government to reduce taxes collected on flights and rent collected from airports. This would be in line with the recommendations of the report of the Standing Senate Committee on Transport and Communications, which suggested eliminating rent collected from airports.

2. Once ADM's municipal taxes are reduced, the Board of Trade would support a concerted strategy led by the Ville de Montréal to have the federal government substantially reduce fees collected from airports and airlines.

2.3 Assemble the necessary resources to reduce the initial financial risk of new flights

Any decision to establish direct flights involves a major initial outlay, for instance, acquiring the aircraft and hiring and training pilots and flight attendants. These expenses are in addition to the operating costs during the early years while traffic is developing. Essentially, the first few years are often financially demanding and can be a disincentive to airlines already dealing with slim, fluctuating profit margins.

Against this backdrop, temporary, well-balanced financial aid could expedite decision making by reducing the initial financial risk for air carriers. A number of organizations, in particular ADM, Tourisme Montréal and Tourisme Québec, have the financial leverage to assemble the monetary resources to encourage airlines to establish new flights. However, it would be a good idea to introduce a permanent, well-endowed mechanism that would have a much greater and well-defined impact on developing new, priority flights. This mechanism could draw from other budget sources. For instance, the Ville de Montréal could support this mechanism if it chooses to maintain the current level of municipal taxes. And the Board of Trade could take part in the effort to mobilize the business community to commit to using the new direct flights.

3. The Board of Trade proposes putting in place a permanent, well-endowed mechanism, supported by the Ville de Montréal, to reduce the initial financial risk of new flights.

2.4 Increase Montréal's attractiveness by supporting demand

Fuel traffic forecasts

To convince airlines of the profitability of flights the community would like, demand is the key. To increase the offer, whether by **adding flights, extending service periods** or **increasing the frequency of existing flights**, it is important to demonstrate sufficient demand to justify the airline's risk. This demand must be supported by a firm commitment from the community, and in this the example of Calgary is an inspiration.

To obtain a direct flight to Tokyo, major corporations in the region mobilized under the leadership of the Calgary Airport Authority to convince Air Canada that it would be profitable. They committed to buying tickets to Tokyo and using Air Canada to ship merchandise to Japan. Plus, to fill aircraft in both directions, Travel Alberta financed a promotional campaign in Japan. A similar strategy was used in Boston with the creation of an Asian Task Force made up of almost 100 people from different economic sectors to fuel traffic forecasts.

4. The Board of Trade recommends that the Ville de Montréal form a committee representing a variety of stakeholders with the mandate of developing a strategy to support ADM's efforts to attract new direct flights and enhance the existing offer.

The Board of Trade would very much like to sit on this committee to represent the business community. The committee would also benefit from the contribution of organizations such as the Ville de Montréal, Tourisme Québec and Tourisme Montréal. In partnership with ADM, the committee's work would be in two stages:

1. **Establish priorities:** to support the **directions chosen by ADM**, the committee should identify the cities of interest to the business community and that represent a potential market for tourism for the city;
2. **Convince the airlines:** companies in Greater Montréal should commit in writing to supporting the strategy chosen to boost traffic forecasts. These efforts could be part of the strategy:
 - a. Led by the Board of Trade, the business community could commit to buying a minimum number of seats and using the airline's services to ship merchandise,
 - b. Tourisme Québec and Tourisme Montréal could finance and develop promotional campaigns in targeted destinations to encourage their residents to visit our city;
 - c. Tourisme Montréal, Tourisme Québec and the Ville de Montréal, working with cultural organizations and the tourism industry, could develop a strategy to extend the tourism season;
 - d. The business community and international companies and organizations with a presence in Montréal could serve as leverage for organizing international conferences in Montréal, particularly in low season.

These are just a few examples of avenues for action that the committee could use to support and boost traffic forecasts with airlines. **The Board of Trade believes that this committee must be where the funds in the mechanism proposed in recommendation 3 are brought together with priorities for air service.**

Leverage Montréal's assets to develop Montréal-Trudeau Airport

Montréal-Trudeau Airport has undergone many improvements in recent years. The additions made to the terminal have greatly enhanced the traveller experience. If, as previously suggested, ADM should strengthen its positioning as a hub between North America and Europe by the time the CETA and a possible Europe-U.S. agreement come into effect, other improvements should be made to enhance Montréal's image with travellers in transit and, indirectly, with airlines.

More travellers in transit means more revenue for ADM from transit taxes and concessions. Concessions and travellers' services are a significant source of revenue for airports. According to a survey by the Airport Council International – North America, revenue from concessions represented around 20% of revenue not directly related to flying. Offering novel services to travellers in transit would reduce ADM's financial dependence on air carriers and increase resources it could devote to incentives to attract new flights.

In line with a trend seen lately in a number of airports, Montréal-Trudeau Airport could become a destination that attracts long-haul travellers through its reputation. For example, some airports have created gardens or museums. Some show movies, lend books or offer activities for children.

When it comes to tourism, Montréal already has an enviable international reputation. This reputation is based on Tourisme Montréal's promotional efforts, but also on the city's creative industry and cultural vitality. **Our city has what it takes to offer in-transit travellers at Montréal-Trudeau Airport an extraordinary experience.** By establishing new partnerships, we can draw on Montréal's strengths and make the airport a showcase for the city. For example, the Musée d'art contemporain de Montréal can exhibit only around 1.5% of its collection due to space limitations.³ Why not use this reserve of works to enhance the collection currently on exhibit at the Montréal-Trudeau Airport Aérogalerie? Partnerships with the UQAM's École de design or with creative companies such as Moment Factory could be developed to give the airport a unique touch. Quebec films could be shown in a screening room to entertain travellers, and consoles showing video games designed in Montréal could be available to young travellers.

In short, developing a strategy to draw attention to Montréal-Trudeau Airport to make it a **tourism and economic showcase** could be one of the mandates for the ADM support committee. This could make Montréal-Trudeau Airport a unique showcase that would convince travellers in transit to return to Montréal for a second trip.

5. The Board of Trade recommends developing a strategy to draw attention to Montréal-Trudeau Airport to make it a tourism and cultural showcase for Montréal, thereby attracting more travellers in transit.

2.5 Improve transfers between the airport and downtown Montréal

3. *La Presse*, December 12, 2011.

If we would like ADM to increase service to Montréal, it seems essential that the airport be well served in terms of transportation. This will make the city more attractive to international travellers and help increase local demand for international flights. Following the example of airports elsewhere in Canada and the world, Montréal-Trudeau Airport must have more efficient transportation than a bus that can take over an hour to reach the airport.

The Vancouver Airport is already connected to the city by light rail transit. Beginning in 2015, express train service will connect Pearson Airport in Toronto to Union Station downtown. The 35 largest airports in the world can or will soon have a rail link (train or metro) to their downtown cores.

Additionally, road work is increasing traffic between downtown and the airport. Past and future work on the Turcot and Dorval interchanges in particular is a major cause of traffic, significantly extending travel time.

It is unrealistic to increase the number of direct flights if, once travellers are at the airport, it is difficult for them to get downtown. The Board of Trade believes it is high time we get behind projects to improve the connection between downtown and the airport, particularly if we want to make the airport a showcase of Montréal's vitality. **The Board of Trade believes that the Ville de Montréal should quickly decide if it wants to formally request the governments of Canada and Quebec to jointly finance a dedicated, rapid rail link between Montréal-Trudeau Airport and downtown.**

6. The Board of Trade calls on the Ville de Montréal to show leadership to improve travel between Montréal's airport and downtown to facilitate access for travellers by again calling on other levels of government to put in place a public transit system and to make traffic more fluid.

Conclusion

The Board of Trade reiterates the strategic importance for Montréal of quality air service. It is a decisive factor in the economic vitality of the city and a number of its economic sectors. This is even truer since, with the limited size of the Quebec market and the CETA taking effect, Quebec companies will be looking to international markets for growth. Not only will Montréal be positioned for Quebec companies that want to access new markets, but with a high-performance transportation sector, **Greater Montréal could position itself as a continental gateway for many markets.**

ADM is putting a great deal of energy and leadership into trying to ensure Montréal has quality air service. That said, flights with clear demand and profitability have already been established. If new opportunities to improve air service soon emerge once the Dreamliner comes into service, adding new links will require more sustained efforts to convince airlines, and **ADM should have the unwavering support of the community to do this.**

To support ADM in its efforts, the Board of Trade believes we need to increase the attractiveness of Montréal-Trudeau Airport with air carriers. To accomplish this, the Ville de Montréal can make ADM more competitive vis-à-vis other major Canadian airports by **reducing municipal taxes**, and it can improve its international positioning by **calling on the federal government** to reduce fees and taxes that affect the price of flights.

To boost ADM's traffic forecasts, the Board of Trade believes that a support committee should be formed, similar to the exemplary initiatives in Calgary and Boston. **Created at the Ville de Montréal's initiative, this committee should be made up of all stakeholders, including the Board of Trade of Metropolitan Montreal,** to develop a support strategy for ADM's efforts to win over airlines. However, the Board of Trade believes that, alongside efforts to obtain flights to markets not currently served, this strategy should **leverage Montréal's positioning as a hub between North America and Europe, the Middle East and North Africa.**

In addition to soliciting airlines, the Board of Trade considers it important to continue improving airport facilities and take this initiative even further by making it a destination in and of itself, one that can play a role of **cultural and creative ambassador for Montréal.** Obviously, this idea goes hand in hand with **improving travel between Montréal-Trudeau Airport and downtown.**

The Board of Trade is convinced that by putting its ideas into action, Montréal could improve its already enviable positioning and introduce new flights.

1. The Board of Trade recommends that the Ville de Montréal show leadership and reduce the municipal taxes collected from ADM.
2. Once ADM's municipal taxes are reduced, the Board of Trade would support a concerted strategy led by the Ville de Montréal to have the federal government substantially reduce fees collected from airports and airlines.
3. The Board of Trade proposes putting in place a permanent, well-endowed mechanism, supported by the Ville de Montréal, to reduce the initial financial risk of new flights.
4. The Board of Trade recommends that the Ville de Montréal form a committee representing a variety of stakeholders with the mandate of developing a strategy to support ADM's efforts to attract new direct flights and enhance the existing offer.
5. The Board of Trade recommends developing a strategy to draw attention to Montréal-Trudeau Airport to make it a tourism and cultural showcase for Montréal, thereby attracting more travellers in transit.
6. The Board of Trade calls on the Ville de Montréal to show leadership to improve travel between Montréal's airport and downtown to facilitate access for travellers by again calling on other levels of government to put in place a public transit system and to make traffic more fluid.