

FOR COUNCIL MEETING OF:
AGENDA ITEM NO: _____

November 9, 2009
4.3 (c)

TO: MAYOR AND CITY COUNCIL
THROUGH: *Linda Norris*
LINDA NORRIS, CITY MANAGER
FROM: *Rick L. Scott*
RICK L. SCOTT, DIRECTOR
URBAN DEVELOPMENT DEPARTMENT

SUBJECT: SUBMITTING A CONNECT OREGON III GRANT ALONG WITH OTHER
OREGON CITIES TO RECRUIT AND RETAIN COMMERCIAL AIR
SERVICE

ISSUE:

Should the City Council authorize the City Manager, along with the City of Klamath Falls and the Coos County Airport District, to submit a joint Connect Oregon III application supporting the return of commercial air service to their respective airports?

RECOMMENDATION:

Staff recommends the City Manager be authorized to submit a Connect Oregon III (COIII) application as a joint applicant with the City of Klamath Falls and the Coos County Airport District and, if awarded, to use up to \$160,000 of General Fund contingencies to satisfy the City's grant match requirement.

BACKGROUND:

The current economic downturn has adversely impacted commercial air service, especially in small markets. All commercial service airports in Oregon have seen a decline in passenger numbers and flights as airlines try to reduce operating costs and increase passenger loads on the remaining flights.

Most airlines serving small communities operate a "hub and spoke" system with small communities feeding passengers to a larger hub with many connecting opportunities. Ticket revenues are shared between the connecting leg and the destination leg. The greater the distance at the connecting leg, the greater the cost of that service. Salem's Delta service had a connecting leg in excess of 600 miles. Delta's attempt to maintain a competitive fare while faced with extremely high fuel prices in 2008 made the service unprofitable. Based on current industry experience, Salem would be more competitive to connect with a closer major hub offering a larger number of connecting opportunities.

FACTS AND FINDINGS:

Public interest in commercial air service has remained strong after the departure of Delta Air Lines. The City Manager and airport staff have monitored the airline industry for realistic opportunities to regain air service to Salem.

A developing opportunity exists to partner with SkyWest Airlines, the largest regional airline in the U.S., and other Oregon communities to return commercial air service to these communities. The first step to take advantage of this opportunity involves Salem joining with the City of Klamath Falls and Coos County Airport District and submitting a CO III grant application to help mitigate the financial risk of the air service. Following the grant application process, staff intends to return to Council with an Intergovernmental Agreement (IGA) with Klamath Falls and the Coos County Airport District to establish the grant administration responsibilities. Grant funding would provide continued service for Klamath Falls and the Coos County Airport District for a two-year period, and new service at Salem for one year. New service has a higher risk, and as a result has a shorter guarantee period.

Regional airline service is only as strong as the connection opportunities at the hub airport. As a part of the contract with the parties, the regional carrier would be responsible for developing the availability for multiple code sharing, for a total project cost estimated at \$2,800,000. With such a system, a passenger flying from Salem could connect to one of several major airlines. The system would increase travel opportunities and help support the success of the service. Multiple code sharing provides a seamless transition between the participating airlines without the need to recheck luggage or purchase separate tickets.

CO III grants require a 20% match and a 2% fee for multi-modal transportation research. The CO III grant request is expected to be \$1,400,000 with the local match being \$308,000. Local match requirements would be negotiated as part of the IGA between Klamath Falls, Coos County Airport District, and Salem based on the frequency and type of air service being supported. Port of Portland, while supporting the efforts of the applicants for CO III grant, would not be receiving additional service and therefore would not be providing matching funds.

Because Salem's service would be new service, it carries a higher financial risk factor and initial airline service costs. Salem's share can be anticipated to be in the \$150,000 to \$160,000 range. The source of the City's matching funds would most likely be General Fund Contingency. No matching funds would be required until the grant was approved and the service started, including the development of the multiple code share agreements. Administrative and reporting requirements would be shared among the participants with Salem assuming overall responsibility.

Because of a short grant application deadline (November 20, 2009), an air service consultant used by Salem and other applicants will be preparing the grant application. The Oregon Department of Aviation has agreed to fund \$24,000 for the preparation of

the grant. Salem will be required as a part of the grant application to fund an additional \$8,000 for market analysis of the new routes the Salem service would generate.

Should the grant be successful and air service reestablished at Salem, additional airport staff may be required depending on number of flights and specific Federal Aviation Administration and Transportation Security Administration requirements. The City can also be expected to commit marketing resources to support the new service.

CONCLUSION:

The airline industry has suffered with the challenge of the current economy. While the role and need for convenient air service is well established, the airlines have reduced service on both non-profitable and marginal routes. Airlines are also more cautious about starting or expanding service. The CO III grant would start new service for Salem and support existing service for Klamath Falls and the Coos County Airport District. Implementation of the grant would provide the multi-code capacity necessary to allow the regional airline greater flexibility in providing flight connections. Such flexibility would provide passengers many more connecting options and improve the possibility of success in serving Oregon communities. Joining with other communities should strengthen the CO III application and could be the most promising opportunity to resume commercial service to Salem.

Report prepared by: Alan Alexander, Airport Administrator
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