

Consultation Paper: Quinquennium 3 (QQ3)

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Sangster International Airport

June 13, 2024



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1 Glossary

'AAJ': Airports Authority of Jamaica

'ACE': additional capital expenditure

'AIF': airport improvement fee

'ATM': air traffic movement

'CAPEX': capital expenditure

'CPI': consumer price index. A measure of general price inflation

'CWIP': construction work in progress

'JCAA': Jamaica Civil Aviation Authority

'NMIA': Norman Manley International Airport

'OPEX': operating expenditure

'QQ2': Quinquennium 2, the previous five-year review of airport charges at Norman Manley International Airport and Sangster International Airport, from 2020-2024¹

'QQ3': Quinquennium 3, the next five-year review of airport charges at Norman Manley International Airport and Sangster International Airport, from 2026-2030

'RAB': regulated asset base

'SIA': Sangster International Airport

'VFR': visiting friends and relatives. A customer segment within the air passenger market.

'WACC': weighted average cost of capital

¹ This period has been extended for one year, so the period now runs from 2020-2025

2 Introduction

2.1 Purpose of this consultation document

The current rates in place at Sangster International Airport (SIA) are due to expire on 31 December 2025.² As such, the Jamaica Civil Aviation Authority (the Authority) has launched a review, as required by the Airports (Economic Regulation) Act 2002 (the Act), to determine the maximum charges and other conditions that should be put in place for the next regulatory period (QQ3), which is now due to commence on January 1, 2026.

This consultation document seeks views from all interested parties on the process, key themes and relevant issues that should affect the regulation of SIA for QQ3. The decisions on the regulatory arrangements for SIA will have significant implications for the airports, airlines, cargo shippers, passengers and other stakeholders in Jamaica.³

2.2 Rate review timetable

This rate review process is a major programme of work and it is important that our decisions are well supported and subject to appropriate consultation.

In our general guidance on the economic regulation of airports from 2003, a timetable for (interim, exceptional and periodic) rate reviews was set out.⁴ The programme of work and timings for the QQ3 review are set out in Table 2.1 below in line with this timetable.

² The current rates had previously been set to expire on December 31, 2024, but the period has been extended by one year, as permitted by the Airports (Economic Regulation) Act 2002 and agreed between the Authority and the airports.

³ The Authority is also carrying out a review into Norman Manley International Airport (NMIA) simultaneously with the review into SIA. A separate Consultation Paper has been prepared relating to NMIA.

⁴ Jamaica Civil Aviation Authority (2003), 'Economic Regulation of Airports: General Guidance', July 24, 2003 p. 9.

Table 2.1 Timetable for the QQ3 rate review

Requirement	Documents produced and Date input required
The Authority to publish a formal notice of the review, identifying the major issues and inviting formal responses	<p>Consultation paper outlining the proposed timetable, consultation process, framework for the review and the Authority's initial views on the key issues.</p> <p>Outline of the information that the Authority will require from airports and users.</p> <p>Airports and other stakeholders to respond to the consultation document by July 26.</p> <p>July 2024</p>
	<p>The Authority to publish a paper that sets out initial positions by August 7.</p> <p>August 2024</p>
The Authority to undertake detailed investigations, including meetings with the main interested parties	<p>Airports are required to submit their business plans to the Authority by September 30, 2024.</p> <p>September 2024–February 2025</p> <p>Authority's review period with ongoing engagement with airports between October 2024 and February 2025.</p>
The Authority to publish proposals, inviting comments and arranging meetings with the main parties	<p>The Authority to publish a draft determination. Airports and other stakeholders to respond by March 2025.</p> <p>February–March 2025</p>
The Authority to issue its decisions, including the new maximum charges (start date of regulatory period minus six months)	<p>The Authority to publish its final determination.</p> <p>26 May 2025</p>
New regulatory period commences	1 January 2026

This timetable is driven by the need to reach a decision six (6) months before airlines and passengers pay the new charges. This is the minimum period for airports to consult with airlines on the detailed structure of the new charges and for these to be available in airlines' systems. At the same time, it is necessary to ensure there is sufficient time for the Authority and all stakeholders to undertake detailed analysis, and to engage in consultation and discussion.

2.3 Responding to this consultation

If you have any views on this consultation document, and in particular on the key questions set out throughout the document and in the Appendix, please submit them as soon as possible to:

Mr Nari Williams-Singh JP

Director General

Jamaica Civil Aviation Authority

4 Winchester Road

Kingston 10

nari.williams-singh@jcaa.gov.jm

All responses to this consultation paper must be submitted by July 26, 2024. We cannot commit to taking into account representations made after this date.

Submissions are welcome on the issues discussed in this document and any other issues that stakeholders consider should be taken into account.

3 Background

3.1 Introduction

This section sets out the context for the QQ3 rate review and the characteristics of the airport that need to be considered in setting the rates. These include the nature of the passengers, airlines and cargo users, the level of airport charges compared with benchmarks, other costs for passengers and airlines, and outcomes, such as the level of investment and service quality. In addition, it is important to consider recent and future developments at SIA, and in Jamaica more generally, and how the legislative framework affects the QQ3 rate review. Further detail on these factors for SIA is included below.

3.2 Context for the review

After the Airports (Economic Regulation) Act was passed in 2002, regulation was introduced for the first time and rates were set for SIA for a 12-year period based on the rates proposed as part of the Concession Agreement between the Government of Jamaica/Airports Authority of Jamaica and the airport operator. The first full rate review was undertaken for the regulatory period that started in 2015. In 2015, the outcome of the first rate review was that airport charges at SIA were increased by 70%, with the entire increase on the passenger service charge. Charges were then set to evolve at CPI - 0% for the next five-year period. It was noted at the time of setting rates in 2015 that SIA had been consistently profitable during the eleven (11) years since privatisation, even given the stagnant demand and low airport charges, due to strong non-aeronautical activity.⁵

The second rate review was undertaken in 2019 for the QQ2 regulatory period from January 1, 2020 to December 31, 2024. It was noted that SIA had performed well over QQ1, with substantial growth in traffic and revenue, an increase in service quality performance, lower operating costs than forecasts, and higher capital expenditure. The outcome of QQ2 was that the charge per passenger increased to \$13.10 in 2020, and by 1% in real terms each year (i.e. CPI + 1%).⁶

Just three months into the QQ2 period, the COVID-19 pandemic caused a sharp reduction in traffic and significant losses in aeronautical and commercial revenue at SIA. Jamaica's borders were closed to all travel between March 21, 2020 and June 15, 2020, and travel restrictions and

⁵ Jamaica Civil Aviation Authority (2014), 'The Sangster International Airport Economic Review Report', November 18.

⁶ Jamaica Civil Aviation Authority (2019), 'Final determination for Sangster International Airport', June.

quarantine requirements for tourists and business travellers remained in place until March 1, 2022. As a result, in 2020, passenger numbers at SIA declined to approximately 1.6m, compared with 4.8m in 2019.⁷ Passenger numbers subsequently increased again over the next few years, and have exceeded 2019 levels, reaching 5.3m in 2023. Yet due to the pandemic, and the related decline in passenger numbers, many assumptions made for the 2020–24 regulatory period did not hold.

3.3 Overview of Sangster International Airport

As noted above, in 2023, SIA facilitated 5.3m passenger journeys. SIA is the largest of Jamaica's three international airports and is located on the north-west coast of the island, in the centre of Jamaica's main tourism region.⁸ Approximately 95% of the passengers at SIA are passengers travelling internationally, and 72% of Jamaica's annual visitors use SIA as their primary airport.⁹

SIA is operated by MBJ Airports Limited (MBJ), a joint venture between Desarrollo De Concessions Aeroportuarias S.A. (DCA), a subsidiary of Mexican-based group Grupo Aeroportuario del Pacifico (GAP), who hold a 74.5% stake, and Vantage Airport Group from Canada, who hold the remaining 25.5%.¹⁰ The Concession Agreement has eight (8) years remaining, running until 2032. This means that there will only be three (3) years remaining in the concession when QQ3 concludes in 2030.

It was noted during the last rate review that CAPEX levels had been consistently (and often substantially) above forecast. CAPEX is expected to have remained high since the last regulatory review, with investments for the principal schemes from QQ2 including the terminal building made in the first year of QQ2, and landside developments from 2020 to 2023.¹¹ In QQ2, there was broad support for this expenditure from airlines.

At the time of the last review, it was also determined that OPEX had been consistently above the forecast level. In QQ2, efficiency targets for several categories of OPEX were set.

⁷ Passenger numbers refer to the number of passengers who embarked, disembarked or transited at the airport.

⁸ See MBJ Airports Limited, 'About MBJ', accessible at <https://www.mbjairport.com/about-mbj>, and MBJ airports limited, 'Airports Facts and Statistics', accessible at <https://www.mbjairport.com/history-facts#:~:text=Airport%20Facts%20%26%20Statistics,the%20primary%20tourism%20destination%20region.>

⁹ MBJ airports limited, 'Airports Facts and Statistics', accessible at <https://www.mbjairport.com/history-facts#:~:text=Airport%20Facts%20%26%20Statistics,the%20primary%20tourism%20destination%20region.>

¹⁰ MBJ Airports Limited, 'About MBJ', accessible at <https://www.mbjairport.com/about-mbj>.

¹¹ Jamaica Civil Aviation Authority (2019), 'Final determination for Sangster International Airport', June.

3.4 Future developments

In deciding on the appropriate rates for SIA at the next review, it is important to take account of future developments at the airport, in Jamaica and wider market trends including those due to COVID-19. The following are considered the relevant factors to be taken into account, though feedback is welcomed from stakeholders on any other key factors.

- **Changes in demand for air travel:** passenger numbers have risen again following the COVID-19 pandemic and have exceeded pre-pandemic levels.
- **Technological improvements:** SIA is expecting to roll out new screening technologies.
- **Concession Agreement:** there are currently eight (8) years remaining on SIA's concession contract.
- **Increased uptake of sustainable fuel:** airlines are now expected to use 5% sustainable aviation fuel (SAF) going forward, and MBJ may need to make investments to support this.
- **Other considerations relating to climate change:** there are other measures which SIA should consider to build its resilience to climate change, in accordance with Annex 16 (Environmental Protection) of the ICAO Convention.

3.5 The Authority's duties

The statutory duties of the Authority need to be central in deciding on the key issues and rates for the next review. In this respect, the duties according to the Airports (Economic Regulation) Act 2002 are:

- further the reasonable interests of users of airports within Jamaica, and provide economical and reliable services to those users by establishing a system for regulation of the airports that takes account of those interests;
- promote the efficient, economic and profitable operation of airports;
- ensure compliance with Jamaica's international obligations, as notified by the Minister;
- create an enabling environment for potential investors in airports;
- encourage investment in new facilities at airports in time to satisfy demands by users of the airports;
- impose restrictions on the operator as consistent with the performance by the Authority of its functions;
- further vital public interests as notified to the Authority by the Minister;
- ensure the airport is operated in accordance with performance standards and service levels that are consistent with best industry practice.

Given that a number of duties are given equal weight of importance, in making decisions there may be the need to prioritise some duties over others. The trade-offs that are being made in taking decisions on specific factors will be clearly set out.

In addition, in making decisions in the exercise of the functions under this Act, the Authority must observe reasonable standards of procedural fairness, act in a timely fashion, observe the rules of natural justice, and also:

- consult with persons who are likely to be affected by a decision;
- provide such persons with an opportunity to make submissions and to be heard by the Authority;
- have regard to the evidence adduced at any such hearing and to the matters contained in any such submissions;
- give reasons in writing for each decision;
- give notice of each decision in the prescribed manner.

The Act also says that, in determining whether to approve airport charges, the Authority shall take account of:

- its objectives (listed above);
- the efficiency of the operations;
- compliance with quality and performance standards;
- performance by the operator in terms of commitments undertaken under the conditions by which they were approved as an airport operator;
- whether the proposed charges would be reasonable in light of the services provided;
- whether the proposed charges can be justified, taking into account revenue from the operations of the airport from all sources, including aeronautical and as much of the non-aeronautical revenues as the Authority deems appropriate.

3.6 Regulatory best practice

The Authority will ensure that account is taken of relevant best practice and lessons from other regulatory regimes, including regulatory regimes at international airports and across other sectors both in and outside Jamaica. Stakeholders' views are welcomed on particular examples that should be taken into account, particularly where the relevance of these examples to the Jamaican context is demonstrated.

4 Stakeholder engagement

4.1 Objectives and key principles of stakeholder engagement

Stakeholder engagement is a key feature of many regulatory regimes around the world. Through this process, a company proactively discusses, and engages with customers on, its plans for the period. It then uses this engagement to inform its business plan.

Stakeholder engagement between the Authority and airports, and between SIA and its stakeholders, will be an important feature of this regulatory review. In response to stakeholders noting that they expected to be more involved going forward during the 2015 regulatory review,¹² the importance of stakeholder engagement was reinforced during the last regulatory review, in particular in the preparation of airport's business plan.

Further engagement between SIA and its stakeholders is encouraged during this regulatory review. It is expected that the airport will seek input from stakeholders on the key outcomes that they want from the airport. For instance, one issue that should be discussed is the investments required and the prioritisation of different investment options. Other issues that will need to be discussed in the context of deciding on the appropriate level of prices are the volume of passengers expected and the overall level of service that will be provided.

The engagement process functions more smoothly if there are some key principles to guide this process, as follows.¹³

- The discussions should be focused on delivering outcomes that customers value.
- All parties should provide relevant information in a timely manner, including responding to queries.
- All parties should engage constructively and in good faith.

Ideally, SIA should seek to have agreement on key issues during the development of its business plan in a way that ensures good outcomes for customers. Indeed, the process of engagement can be valuable in narrowing the differences and areas of disagreement between the parties. However, we appreciate that the interests of stakeholders are likely to diverge in some cases. In these cases, stakeholder engagement

¹² See Oxera (2017), 'Key issues for the 2020 rate review'.

¹³ Adapted from UK Civil Aviation Authority (2017), 'Strategic themes for the review of Heathrow Airport Limited's charges ("H7"): A discussion document', CAP 1383, p. 27.

can still be valuable in ensuring that different parties are able to provide informed views to the rate review process.

Evidence of stakeholder engagement must be reflected in the airport's business plan. SIA should highlight the areas of agreement with stakeholders, and in areas where agreement cannot be reached, the reasons for differing views should be set out.

Stakeholder engagement should be led by the airport rather than the regulator. Therefore, the Authority will generally not take part in such discussions but may attend as an observer. Ultimately, the regulator will also make the final decisions on most of the appropriate parameters for the rate review, and in doing so, there will be the need to ensure that the interests of both current and future customers (i.e. passengers) are taken into account.

There are some areas where it may be more reasonable than others for the parties to engage and reach agreement. For instance, while stakeholder engagement is welcomed on areas such as the appropriate WACC or RAB valuation, the Authority will continue to have the ultimate role in determining the approach in these areas. However, it would be reasonable to expect engagement and agreement with stakeholders on, for example, the level of service quality desired, traffic forecasts and the capital investment programmes.

To the extent that there is evidence of good customer engagement, and in areas where there is broad agreement between the airport and stakeholders, there will be less regulatory scrutiny (with the exception of highly technical areas, as outlined above). Therefore, the more effective the consultation, the more efficient the rate review will be, since detailed analysis will only have to be undertaken for areas of difference between the parties.

On issues where the parties are unable to agree, the airport should highlight how it has taken airlines' feedback into account and the reasons for the parties' different positions.

4.2 Questions for consultation

Please submit responses to the following questions and other related issues.

1. Do you consider that the proposed approach to stakeholder engagement is appropriate? Are there any changes you suggest to this process?
2. Do you agree with the key principles set out to guide stakeholder engagement? Are there other principles that should be considered?

5 Form of regulation and setting the rates

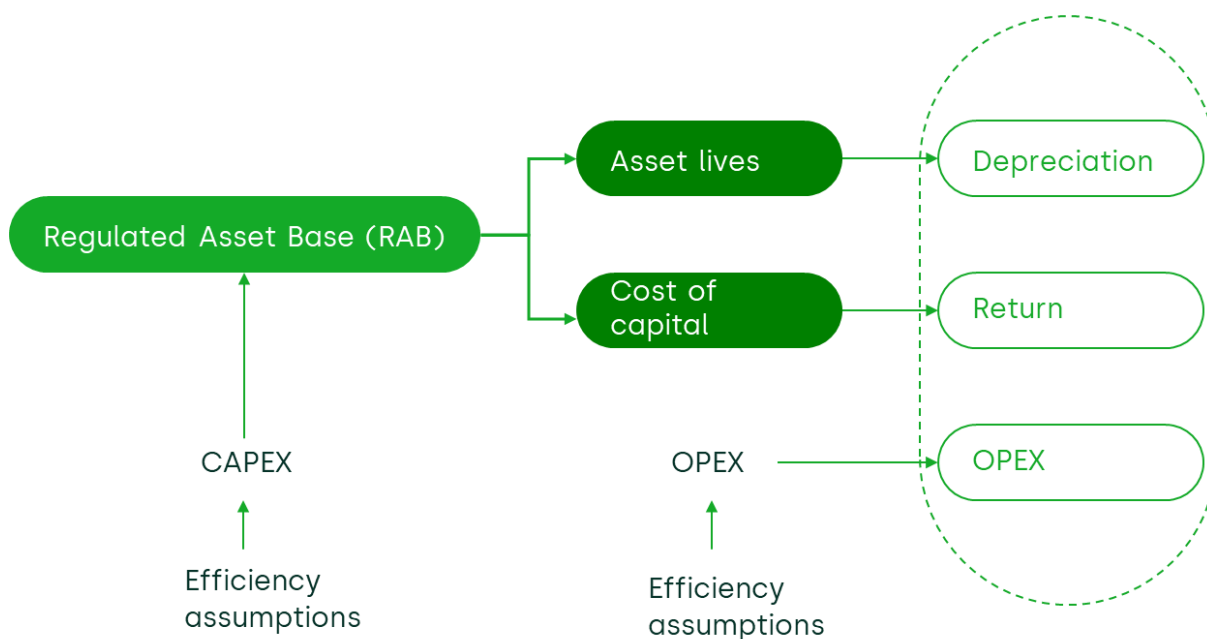
5.1 Form of regulation

There are a number of different types of regulatory regimes used at international airports and across other sectors. As part of the QQ2 review, the Authority established a form of incentive regulation based on an ex ante charge control that capped charges at a level that allows the company to recover the efficient level of costs incurred in providing the regulated service. At the same time, the company bears the risk of earning low profits or losses if it is unable to control its costs and meet the regulator's forecasts. Typically, regulated charges are expressed on a forward-looking basis in real terms—that is, they are adjusted for changes in price levels through a formula based on the principle of $CPI - X$, where CPI is the rise in consumer prices and X is an efficiency factor.¹⁴

One important regulatory decision is whether the cap is set on total revenues or price per passenger. During QQ2 the Authority set a price cap on the price per passenger which is a commonly used approach at international airports. This places the risk of actual passenger volumes deviating from forecasts on the airport, so that the airport stands to gain if passenger numbers are greater than those forecasted, but it might not be able to earn its target rate of return if passenger numbers are lower than forecasted. The total revenue requirement was calculated as the sum of depreciation, the efficient level of OPEX, and a target return on assets. In the case of SIA, the Concession Fee was also included before determining the total revenue requirement. These building blocks are illustrated in Figure 5.1 below.

¹⁴ It is also possible to have charges expressed in nominal terms, which means that the company bears all the risk of inflation in the economy varying from the levels used in the regulator's forecasts.

Figure 5.1 Building blocks for setting the price cap



Source: Oxera

In addition to the overall cap, the way that charges are structured within the cap can have implications for the type of traffic that is incentivised to use the airport. For example, higher charges at peak times than at off-peak times may incentivise airlines to shift to off-peak times. Similarly, charges could be set lower for the lower-demand season than the higher-demand season in an attempt to encourage traffic throughout the year. In some regulatory regimes, airports are provided with the flexibility to determine, and change, the structure of charges within the overall charge cap set by the regulator. The changes are often limited to once or twice a year, and users need to be consulted in advance of any change.

In QQ2 airports were provided with the flexibility to set the structure of charges and undertake periodic or annual rebalancing of airport charges within overall guidance and approval from the Authority. However, it was reiterated that it was important to ensure that the airport consulted with users on any changes in the structure of charges.

5.2 The Authority's initial position

The Authority continues to consider that the most appropriate form of regulation to apply for the QQ3 regulatory period is the incentive-based regulation applied in QQ2 (i.e. a price cap based on a RAB-WACC approach).

The rate of return for each airport will be determined based on a forward-looking estimation of the weighted average cost of capital, or WACC.¹⁵ An appropriate approach for estimating the WACC parameters (based on the capital asset pricing model) that will take account of the impact of COVID-19 on market data will be proposed.

Within the overall cap, the Authority considers that airports should be provided with flexibility to set the structure of charges and undertake periodic or annual rebalancing of airport charges within guidance from the Authority. However, it will be important to ensure that the airports consult with users on any changes in the structure of charges.

Airports should also be permitted to offer airlines discounts below the maximum price cap. However, any charges and discounts must be set in accordance with ICAO's Doc 9082, which promotes four charging principles—consultation, non-discrimination, cost-relatedness and transparency.

5.3 Questions for consultation

Please submit responses to the following questions and other related issues.

1. Given your experience over QQ2, do you consider that incentive regulation based on a RAB–WACC building blocks approach remains an appropriate regulatory approach for QQ3? If not, what form of regulation do you consider would be more appropriate given the Authority's duties, and why?
2. Do you agree that airports should be provided with the flexibility to set the appropriate structure of charges (within an overall cap), subject to consultation with airlines and guidance from the Authority?
3. Do you agree that airports should be provided with the flexibility to undertake periodic or annual rebalancing of airport charges subject to final agreement from the Authority?

¹⁵ The regulatory WACC allowance may differ across the regulated airports if they are found to face different levels of exposure to risk.

6 Till regime

6.1 Overview of till regimes

Airports can derive revenue from two main categories of activities— aeronautical activities¹⁶ and non-aeronautical (commercial) activities.¹⁷

The distinction between till regimes relates to whether, and the extent to which, non-aeronautical activities are taken into account in determining the charges that the airport levies on airlines and passengers. The Airports (Economic Regulation) Act allows for the adoption of any type of till regime.

There are three possible options for the till regime which have previously been considered.¹⁸

1. **Single-till:** in a single-till regime, the costs and revenues of both the aeronautical and commercial activities of an airport are taken into account in determining the level of airport charges. The cost base includes the overall level of costs required to provide all services at the airport, not just those services for which charges are regulated. All commercial revenues are used to offset the cost base and the charges to airlines. The RAB therefore comprises a combination of aeronautical and non-aeronautical assets.
2. **Dual-till:** in a dual-till regime, only the core aeronautical activities are taken into account in determining the level of airport charges, with the airport retaining all non-aeronautical revenue. Airport charges are derived on a stand-alone basis, so aeronautical revenues must cover only costs associated with aeronautical activities, including a reasonable return on those activities.
3. **Hybrid-till:** a hybrid-till regime avoids the binary choice between a single and dual till, and instead considers which activities and/or revenues should be included in the till, and/or the extent to which commercial profits should be shared between the airport and users.

There is a considerable body of literature setting out the merits of different till regimes. Below, some of the key factors that are important to take into account when determining an appropriate regime are highlighted.

¹⁶ Aeronautical activities relate directly to providing services for aircraft and airline passengers, including runways, aircraft parking and terminals. Revenues for these activities are derived from the charges that the airport levies on airlines or passengers.

¹⁷ Activities that are co-located with, but are not essential for, the production of aeronautical activities. Revenues from these activities are derived from concessions in the terminal (such as duty-free shops), car parking, car rental, or the provision of property-related services.

¹⁸ Oxera (2017), 'Key issues for the 2020 rate review', 11 September, section 7.2.

- **Effect on charges.** One common justification for a single-till regime is that it leads to lower charges than a hybrid- or dual-till regime, as commercial revenues are used to reduce aeronautical charges. Proponents of a dual till often claim that the lower charges in a single till relative to a dual till do not necessarily lead to a benefit for passengers in terms of lower prices, particularly if the airport is capacity-constrained.
- **Economic efficiency.** It is often argued that there is a relationship between the prices of aeronautical and commercial services, such that a decline in the price of one leads to an increase in demand for the other. To the extent that this is the case, economic theory would suggest that the most efficient way for an airport to operate would be to set these prices together. This would imply a single-till regime leads to the most efficient outcomes. However, in reality this relationship between aeronautical and commercial products is unlikely to be exact.
- **Ease of administration.** One of the commonly identified advantages of the single-till is that it is relatively straightforward to administer, since it does not require cost allocation between aeronautical and commercial services. Under a dual or a hybrid-till, it is necessary to define the activities that the regulated till would cover, in order to determine which costs and revenues should be taken into account when setting the price cap for airport charges.
- **Market power.** It is relevant to consider whether airports have significant market power (SMP) in relation to commercial activities in order to determine the appropriate till regime. But even if airports have SMP with respect to commercial activities, direct regulation of these activities or an overall commercial price cap could be more effective methods than a single-till regime.
- **Incentives for investment.** The choice of till regime may also have an effect on investment incentives in terms of both the level of overall investment and the type of investments undertaken.

For QQ2 the Authority proposed a hybrid-till regime, under which a proportion of commercial revenue is used to cross-subsidise aeronautical revenue and reduce the level of the overall charges cap. This was selected as the most appropriate approach in this case as it was considered that, while aeronautical and non-aeronautical services were not perfectly complementary, there were likely to be some demand dependencies between the two.

The following points were also noted:

- A hybrid-till regime may be optimal in terms of economic efficiency, as it allows an airport to use some of its profits from non-aeronautical activities—those for which there is a clear

direction of causation from aeronautical activity to non-aeronautical income—to contribute to the costs of aeronautical services without the complete cross-subsidy required under a single-till regime, or no cross-subsidy in a dual-till regime.

- A single-till would not necessarily provide the appropriate incentives for the airport to focus on non-aeronautical activity and revenue. As SIA is a relatively expensive destination when considering taxes and charges, using a proportion of non-aeronautical revenue to reduce charges may be helpful in driving traffic growth at the airport.

Within a hybrid-till approach, there are three main options for revenue sharing, which are activity-based hybrid-till, fixed revenue-sharing and dynamic revenue-sharing. Within the hybrid-till approach, the fixed revenue-sharing option with a sharing rate of 70% was selected in the previous regulatory review. This was considered to be the most appropriate approach, as it ensures that charges remain competitive while providing the appropriate incentives to the airport.

It is noted that that in its consultation response for the QQ2 regulatory review, MBJ expressed its preference for a mixed hybrid and dual till regime whereby the Authority would set the revenue share level (70/30 split) but have a dual till regime for any incremental non-aeronautical revenues above that level. It is noted that MBJ has expressed interest in re-visiting the current revenue sharing rate in this regulatory review.

6.2 The Authority's initial position

It is proposed to continue with a hybrid-till regime with the fixed revenue sharing option in QQ3, as we consider that this is still the most appropriate option.

6.3 Questions for consultation

Please submit responses to the following question and other related issues.

1. Do you agree that the hybrid-till regime applied in QQ2 is still appropriate for SIA for QQ3?

7 Capital expenditure

7.1 Setting the RAB

The opening RAB for 2026 will inform the charges for the next period. There are several approaches that can be used and the Authority proposes to set the RAB following the same approach that was used in QQ2.

Our first reference for setting the RAB will be the RAB values available in the airport's regulatory accounts. These will be retained to the extent the principles and approaches used to set the value are consistent with regulatory best practice.

In QQ2 it was agreed that CAPEX would not be fully paid for over the regulatory period. New CAPEX was added to the RAB each year, and the airport earned a return (WACC multiplied by the RAB) and a depreciation charge. For most assets it was considered that the depreciation profile would be more than five years, and as such the assets would be remunerated over a longer period of time.

Some regulators allow construction work in progress (CWIP) into the RAB for certain projects. In QQ2 the Authority suggested to MBJ that it would be willing to consider allowing CWIP into the RAB for specific assets if MBJ provided justification according to International Civil Aviation Organisation (ICAO) guidelines.¹⁹ As MBJ did not put forward any example projects, no CWIP was included in the RAB.

In this regulatory review, the impacts of COVID-19 on the RAB, including how best to account for deviations between forecast and actual CAPEX due to COVID-19, and the impact of the one-year extension of the regulatory period, will also be considered.

7.2 Setting CAPEX forecasts

A core feature of the RAB-WACC model is its separate treatment of expenditure on infrastructure (CAPEX), such as a new terminal or pier, and expenditure on day-to-day running costs (OPEX), such as employee pay and maintenance costs. In determining the allowed revenue, the efficient level of CAPEX will need to be determined based on engagement with users or by the Authority monitoring the processes the airport has put in place when procuring the work required to fulfil user requirements. This is consistent with the Authority's duty under the Airports (Economic

¹⁹ ICAO (2012), 'ICAO's Policies on Charges for Airports and Air Navigation Services', Doc 9082, para. 23.

Regulation) Act to 'encourage investment in new facilities in time to satisfy demands by users of the airports'.

The airport is expected to engage with users on the schemes required and desired.

7.3 Airport improvement fee

The AIF is levied by the Jamaican government on international departing passengers and is intended to be used to pay for assets approved by the Minister of Transport. The fee will remain in place at SIA until 2030.

It was noted at the time of the last rate review that the AIF at SIA was being used to fund the runway extension. The AIF was not included in the RAB and was separate from SIA's capital expenditure forecasts.

7.4 Dealing with deviations from CAPEX forecasts

While it is important to set robust CAPEX forecasts at the outset of the rate review, actual CAPEX may deviate from forecasts for a number of reasons. This includes changing airport circumstances, including cases where additional investment is required, cases where the airport has underspent due to deferring or cancelling agreed capital projects, and cases where it has overspent or underspent while delivering on the agreed programme.

There are several mechanisms that can be used to deal with differences between actual and forecast CAPEX. This includes the potential for a reopening of the price control under the "exceptional clause" provision in the Act; an agreed process for dealing with proposed changes to the capital programme within period; or an adjustment mechanism that is agreed in advance. It could also be the case that the airport has underspent or overspent while delivering the agreed programme as a result of efficiencies or inefficiencies, in which case the airport may be required to bear the pain or retain any additional profits from this.

In QQ2, it was determined that any under- or overspend due to changes in projects or spending less/more on agreed programmes would be addressed at the end of the QQ2 period by a 'logging-up' or 'logging-down' procedure. For example, if an airport needed to spend more on a particular capital investment than initially allowed for by the regulator, and this additional expenditure was efficient, the regulator may allow (a portion of) this CAPEX in the RAB at the next rate review, by increasing the opening RAB for the following period. This would be considered in advance of setting prices for QQ3.

By contrast, it was determined that if the airport underspent or overspent while delivering an agreed program as a result of efficiencies or inefficiencies, no adjustments would be made. The company would be required to bear the pain of any inefficiencies, and would retain the additional profits from outperforming on efficiencies.

An Additional CAPEX Expenditure mechanism (ACE) was proposed for the case where new projects arise during the course of the regulatory review that would be in the interests of users, but which were not forecasted at the start of the period. This mechanism would allow the Authority to approve CAPEX during the regulatory period subject to following a pre-specified and published methodology. Any additional CAPEX approved would lead to an adjustment of the charges cap within the period. This mechanism, though proposed, was not implemented in practise during QQ2.

The ACE mechanism was proposed to function as follows:

- The airport would consult airlines on any proposed new CAPEX projects through an airport CAPEX consultative committee (including all airlines with more than 100,000 passengers in the preceding 12 months).
- The aim would be for the airport and airlines to agree on: (i) the need for the project; and (ii) the price adjustment required to reflect the additional CAPEX requirement.
- Following consultation, the airport operator would bring forward its proposals and supporting evidence (including additional CAPEX and OPEX requirements, traffic forecasts, and information on the consultation process) to the Authority.
 - Projects for which airlines agree on the need for the project and the proposed price adjustment would typically be expected to receive regulatory approval with minimal scrutiny.
 - Where there is agreement on the need for the project but not the price adjustment, the Authority would review and decide whether to accept the airport's proposal or modify it. If the project scope and price proposal are accepted, the airport would be expected to proceed on the proposed terms. If the regulator made significant modifications to the project or price adjustment, the airport could decide not to proceed (and there would be no change to the price cap).
 - Finally, if airlines oppose the project or no consensus is reached, but the airport believes that the project would be in the public interest, the Authority would review whether there was sufficient justification for the investment and the appropriate price adjustment. As above, in the event of substantial modification to the airport's initial proposal, the airport could decide not to proceed with the project at this stage.

7.5 The Authority's initial position

In line with QQ2, the first reference for setting the RAB will be the RAB values available in the airport's regulatory accounts. These will be retained insofar as the principles and approaches used to set the value correspond to regulatory best practice.

There will be consultations on any adjustments which need to be made in light of the issues set out above. For example, the Authority will consider how to deal with CAPEX during the COVID-19 pandemic and the approach to handling airports' recovery from COVID-19. The approach to including CWIP in the RAB will also be considered.

It is important for the airport to establish robust CAPEX forecasts. However, it is appreciated that CAPEX plans may change over the course of the period. The Authority will consult on the most appropriate mechanisms for making adjustments to take account of differences between actual and forecast differences in CAPEX within the period, including whether the ACE mechanism should be implemented. Consideration will also be given to whether the logging-up and logging-down approach is still the most appropriate for making adjustments at the end of the period.

7.6 Questions for consultation

We welcome responses from stakeholders to the following questions and other related issues.

1. Do you agree with the Authority's proposed approach for setting the RAB?
2. Do you agree with the Authority's proposed approach for setting CAPEX forecasts?
3. Do you consider that the ACE mechanism is appropriate for adjusting CAPEX within period? If not, which alternative mechanism would you propose?
4. Do you consider that the Authority's current mechanism for making adjustments to CAPEX at the end of the regulatory period is appropriate? If not, which alternative mechanism would you propose?
5. Do you consider that Authority's treatment of the AIF in QQ2 should continue in QQ3?

8 Operating expenditure

8.1 Setting OPEX forecasts

A key input into setting the rates for the next period is a determination of the level of efficient OPEX that can be recovered. A company incurs OPEX in the day-to-day running of its business—e.g. rent, salaries, utility costs. OPEX is recovered in the year in which it is incurred, since this expenditure directly relates to providing a service to users today.

In order to set a target for efficient OPEX, it is important to consider which costs are within a company's control and which are predominantly driven by other factors.²⁰ In general, most costs will be somewhat controllable, particularly in the long run, and the majority of costs should therefore be included in controllable OPEX. However, there are some costs that are likely to be uncontrollable, and for these costs partial or full pass-through may be warranted such that the airport does not bear the risk of actual costs deviating from forecasts. One such example of uncontrollable expenditure is security costs, discussed in Section 9.

Table 8.1 shows our classification of each cost category as controllable or uncontrollable in QQ2.

Table 8.1 SIA OPEX categories

Expense line	Controllable or uncontrollable?
Personnel	Controllable
Training and development	Controllable
Security	Uncontrollable
Maintenance	Controllable
Janitorial, sanitation and landscaping	Controllable
Other contracted work	Controllable
Rental	Controllable
Corporate costs (YVRAS management and additional services)	Controllable

²⁰ Controllable costs are OPEX items over which the airport operator has influence or a considerable degree of control. Uncontrollable costs are OPEX items where, while the airport may still have some degree of influence, public policy or market factors determine the level of costs that the airport has to bear to a considerable extent.

Expense line	Controllable or uncontrollable?
Environmental work	Controllable
Materials and supplies	Controllable
Utilities	Controllable
Incinerator recovery (negative)	Controllable
Regulatory fee	Uncontrollable
IATA collection fee	Uncontrollable
Office and administration	Controllable
Travel and hospitality	Controllable
Audit, accounting, bank services, legal, advisories and board activities	Controllable
Marketing and promotion	Controllable
Insurance	Controllable
Bad debt	Uncontrollable
Concession fee	Uncontrollable
Irrecoverable GCT	Uncontrollable

In QQ2, efficiency targets for all controllable cost items were set. In assessing efficient OPEX for SIA's controllable expenditure, the starting point was the average unit OPEX in QQ1. The elasticity of unit OPEX to passenger numbers was fixed to one over QQ2 for controllable items—i.e. $\Delta\text{OPEX} / \Delta\text{Passengers} = 1$.

This was considered to be a conservative estimate which allows for any efficiencies achieved through economies of scale to be recovered by MBJ as outperformance. Increases in expenditure for some expenditure lines were allowed where this was evidenced by MBJ, but efficiency targets were still applied. A cost pass-through mechanism was applied for security costs (discussed in section 9 below).

In this regulatory review, specific consideration will be given to the effect of the COVID-19 pandemic on OPEX, and any adjustments that will need to be made in this context. For example, this might include how to account for the airport facing lower passenger numbers while some costs remained fixed during COVID-19. The Authority will also consider the impact of other changes to the external environment on the efficient level of OPEX.

8.2 Input price pressure

It is likely that the continued use of US CPI will be appropriate as a measure for overall inflation at the QQ3 rate review. In addition to controlling for economy-wide measures of inflation it is also important to control for how the prices of specific inputs may differ. For example, wage costs might be expected to grow by 3%, relative to general inflation of 2%. If staff costs were to make up 20% of OPEX, then the net amount of inflation allowed would be 2.2%.²¹

SIA should submit evidence for areas of OPEX in which it considers that input price growth is likely to differ from US CPI. It is expected that evidence submitted in support of an input price pressure claim will:

- clearly link expected price growth to credible economic indicators;
- explicitly link these prices to input factors;
- demonstrate that all possible steps to mitigate the impact of the price pressure available to management have been taken.

8.3 The Authority's initial position

SIA should provide submissions about the cost items that it considers to be controllable and those that it considers to be uncontrollable. To the extent that this differs from the Authority's classification, it would be helpful if SIA could provide justification for its position.

As in QQ2, efficiency targets will be set for controllable cost items. There will be no efficiency target applied to uncontrollable cost items. However, other than for security costs, it is not proposed to allow for a pass-through if forecasts differ from actual costs.²²

The Authority will consult on changes to the efficient OPEX levels resulting from the COVID-19 pandemic, as well as other factors which may affect the efficient level of OPEX going forward.

It is proposed to use US CPI as a measure of general inflation. Evidence of additional input price pressure should be submitted for consideration as part of the rate review process.

8.4 Questions for consultation

Please submit responses to the following questions and other related issues.

²¹ $80\% \times 2\% + 20\% \times 3\%$.

²² In the case of security costs, expenditure is passed directly through to consumers. This reflects the nature of expenditure on security costs, which form a large proportion of the airport's uncontrollable costs and, unlike in the case of other uncontrollable costs, there is no formal process for the airport to contribute to the determination of security costs. For a further discussion of security costs, see section 3 below.

- 1 Do you agree with the Authority's proposed classification of controllable and uncontrollable costs?
- 2 Do you agree with the Authority's proposed treatment of controllable and uncontrollable costs? Other than security costs, are there any other costs which you consider should be subject to a pass-through mechanism?
- 3 Do you agree with the Authority's approach to handling input price pressure?

9 Security costs

9.1 Approach to security costs

As noted in the previous section, security costs have historically been treated as an uncontrollable cost item as part of OPEX. Security procedures are determined by the Jamaican government, and international requirements and security staff are provided by a government body (Port Security Corps). The airports have limited ability to determine the contractual terms. For this reason, unlike other uncontrollable cost items, for which pass-through was not allowed if forecasts differed from actual costs, security expenditure is allowable to be passed directly through to customers in QQ2.

Both international airports have indicated that they have experienced significant increases in security costs as a result of legal changes which have increased costs to security providers.

9.2 The Authority's initial position

Given the increase in security costs and the one-year delay in the start of the regulatory period to January 1, 2026, the Authority will consider adjustments for the period between January 1, 2025 to December 31, 2025 separately to the current QQ3 review process. This will determine any adjustments to be implemented as of 1 January 2025. As this is being dealt with through a separate process, views are not being sought on this as part of this consultation document.

Increases in security costs from 2026 onwards will be taken into account during this rate review. It is proposed to continue to apply a pass-through mechanism for additional security costs above the forecast amount, subject to receiving sufficient evidence.

9.3 Questions for consultation

Please submit responses to the following question and other related issues.

- 1 Do you have any views on the Authority's initial proposals in relation to the regulatory treatment of security expenditure for QQ3?

10 Service quality regulation

10.1 Overview of service quality performance

SIA collects a significant amount of information about performance, which it submits to the AAJ and the Authority. This includes comment cards—passenger satisfaction questionnaires administered and analysed by the airport on a periodic basis—and passenger satisfaction surveys undertaken by an external party (as required under the Concession Agreement). These look at:

- passenger satisfaction (for example, with respect to access, quality of airport facilities, flight information, and courtesy of staff);
- baggage-handling indicators (such as delivery and waiting times for luggage);
- availability and repair times for airport facilities (such as elevators and conveyors).

There are minimum and target mean scores set for each area.

Over the last few years, SIA has made significant investments of \$70 million to improve service quality. In particular, this includes an investment in a terminal expansion with an 'expansion of the immigration hall and departure lounge, upgraded retail space and the opening of the Bob Marley (One Love) restaurant.'²³ Investments were also made in passenger processing systems and the passenger check-in area, which now 'houses 60 upgraded Common Use Self Service Kiosks [...] to reduce processing times and wait times.'²⁴

Finally, the 408-metre runway extension will also support better service quality at SIA as a means of enhancing 'operational capabilities [...], higher payloads and increased visitor traffic. It also opens new gateways and routes, making Jamaica even more accessible to the world.'²⁵

²³ See Travel Agent Central (2023), '[Jamaica's Montego Bay Airport Debuts Enhancements](#)', September.

²⁴ See MBJ Airports Limited, '<https://www.mbjairport.com/airport-development>', last accessed 30 May 2024.

²⁵ See Lagan Aviation & Infrastructure, '[Sangster International Airport](#)', last accessed 30 May 2024.

10.2 Incentivising service quality improvements

The Airports (Economic Regulation) Act specifies that the Authority should carry out its functions in a manner that will 'ensure that the airport is operated in accordance with performance standards and service levels consistent with best industry practice.'

Several regulators, in the aviation sector and across sectors, have looked to implement service quality incentives in addition to, or as part of, price controls. Such incentives have been introduced for different objectives: shielding customers from unexpected failures in service; safeguarding current service levels; raising current service levels to, or above, those of competitors; or differentiating the service package provided by the airport from its competitors in terms of its scope or style.

The Concession Agreement under which SIA operates requires MBJ to monitor and comply with set performance standards under a reputational incentive approach. Service quality reporting and monitoring is undertaken by the AAJ and the Authority to ensure this minimum service level is achieved.

During QQ2 it was determined that further service quality regulation should not be introduced, as the scheme imposed by the Concession Agreement already covered a number of important indicators that affect customer experience. It was also determined that, in addition to the scheme outlined in the Concession Agreement, SIA should publish its service quality performance quarterly, in the airport and on its website to provide some level of further monitoring and oversight.

However, that service quality information was not published over the QQ2 period, which may have been due, in part, to the COVID-19 pandemic.

10.3 The Authority's initial position

There is already monitoring (for example, reporting minimum standards in the Concession Agreements to the AAJ and the Authority) of service quality at SIA. In this regulatory review it will be considered whether the current approach to service quality regulation is appropriate.

Given the level of CAPEX that SIA invested in QQ2, it may be reasonable to expect higher levels of service quality and service quality targets in the QQ3 period. This position was set out in the final determination for QQ2.

During this regulatory review, the Authority will also consider whether the service quality information which we determined should be published by SIA in QQ2 is still appropriate in light of changing trends due to the COVID-19 pandemic as well as other future developments discussed in section 3.

10.4 Questions for consultation

We welcome responses from stakeholders to the following questions and other related matters.

- 1 Do you consider that the measures discussed above for incentivising service quality are appropriate for QQ3? Please explain why or why not.
- 2 If you do not consider that these measures are appropriate, what would you propose as an alternative?
- 3 What areas do you think are important to monitor for service quality performance?

11 Depreciation

11.1 Setting depreciation profiles

In QQ2 it was determined that all CAPEX should be depreciated to the end of its useful economic life rather than to the end of the concession period. For CAPEX categories that were recorded as having a 4-, 5-, 10- or 20-year life in MBJ's model, these asset lives were used. For CAPEX categories that were listed as LOC (life of concession), useful economic life of 30 years was applied. A straight line depreciation profile was applied for all assets.

It was also determined that arrangements should be made between the AAJ and SIA to ensure that any undepreciated CAPEX was recouped at the end of the Concession Agreement. This approach was taken as it was considered that depreciating assets to the end of the concession period would lead to customers under- or overpaying for certain assets, depending on the lifetime of the asset and when it was constructed.

In particular, taking an approach to depreciate assets to the end of the concession period would have led to the following outcomes, that are not in the customer interest.

- Short-lived assets that were built early in the concession period would be remunerated over the entire concession period. As a result, passengers in the early part of the concession period would underpay for these assets, while passengers towards the end of the period would be contributing towards an asset no longer in use.
- Long-lived assets that were built towards the end of the concession period would be fully remunerated before the end of the asset's expected lifetime. This would mean that passengers during the concession period were overpaying for the asset, while customers after the end of the concession period would benefit from an asset without paying for it.

Depreciating to the end of the concession period would have also led to difficult choices at the end of the concession period, as a trade-off would have to be made between deferring long-lived investments to the next concession period or significantly increasing charges for a period of time.

As such, the Authority's final determination was that all CAPEX would be depreciated to its useful economic life rather than to the end of the concession period, and that arrangements need to be made between the AAJ and SIA to ensure that any undepreciated CAPEX is recouped at the end of the Concession Agreement.

11.2 The Authority's initial position

In this regulatory review, the Authority will consider its approach to the depreciation of assets. Specifically, whether the approach taken in QQ2 of depreciating all assets to the end of their useful economic life is still appropriate.

11.3 Questions for consultation

Please submit responses to the following question and other related issues.

1. Do you agree that the Authority's approach in QQ2 of depreciating CAPEX to the end of its useful economic life is still appropriate in QQ3? If not, what alternative approach would you propose and why would it represent a better outcome for customers?

12 Conclusion

This consultation document has set out the process, key themes and relevant issues for the next rate review of SIA. The Authority is seeking views from interested parties on all of the issues discussed in this consultation document in advance of finalising our proposals for the regulation of SIA for QQ3. Input on issues that have not been addressed in this consultation document, but which stakeholders consider to be important to take into account, is also welcomed.

A1 Questions for consultation

We have set out the questions on which we are seeking stakeholder engagement throughout this document. These questions are summarised, by topic, below.

Stakeholder engagement

- 1 Do you consider that the proposed approach to stakeholder engagement is appropriate? Are there any changes you suggest to this process?
- 2 Do you agree with the key principles set out to guide stakeholder engagement? Are there other principles that should be considered?

Form of regulation and setting the rates

- 1 Given your experience over QQ2, do you consider that incentive regulation based on a RAB–WACC building blocks approach remains an appropriate regulatory approach for QQ3? If not, what form of regulation do you consider would be more appropriate given the Authority's duties, and why?
- 2 Do you agree that airports should be provided with the flexibility to set the appropriate structure of charges (within an overall cap), subject to consultation with airlines and guidance from the Authority?
- 3 Do you agree that airports should be provided with the flexibility to undertake periodic or annual rebalancing of airport charges subject to final agreement from the Authority?

Till regime

- 1 Do you agree that the hybrid-till regime applied in QQ2 is still appropriate for SIA for QQ3?

Capital expenditure

- 1 Do you agree with the Authority's proposed approach for setting the RAB?
- 2 Do you agree with the Authority's proposed approach for setting CAPEX forecasts?
- 3 Do you consider that the ACE mechanism is appropriate for adjusting CAPEX within period? If not, which alternative mechanism would you propose?

- 4 Do you consider that the Authority's current mechanism for making adjustments to CAPEX at the end of the regulatory period is appropriate? If not, which alternative mechanism would you propose?
- 5 Do you consider that Authority's treatment of the AIF in QQ2 should continue in QQ3?

Operating expenditure

- 1 Do you agree with the Authority's proposed classification of controllable and uncontrollable costs?
- 2 Do you agree with the Authority's proposed treatment of controllable and uncontrollable costs? Other than security costs, are there any other costs which you consider should be subject to a pass-through mechanism?
- 3 Do you agree with the Authority's approach to handling input price pressure?

Security costs

- 1 Do you have any views on the Authority's initial proposals in relation to the regulatory treatment of security expenditure for QQ3?

Service quality regulation

- 1 Do you consider that the measures discussed above for incentivising service quality are appropriate for QQ3? Please explain why or why not.
- 2 If you do not consider that these measures are appropriate, what would you propose as an alternative?
- 3 What areas do you think are important to monitor for service quality performance?

Depreciation

- 1 Do you agree that the Authority's approach in QQ2 of depreciating CAPEX to the end of its useful economic life is still appropriate in QQ3? If not, what alternative approach would you propose and why would it represent a better outcome for customers?

