



Germany's regional airports under political and economic pressure

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The total passenger volume at German regional airports decreased steadily from 2010 to 2014. In a longer-term comparison, the volume in 2014 was barely 5% higher than in 2005. During the same period, the larger German airports experienced growth of 25.6%. In 2014, regional airports generated approx. 8% of total passenger volume in Germany.

The range of flights available at most regional airports remains small. Flights to traditional holiday destinations dominate. Therefore, the anticipated positive effects on the local economy are small, as are the transport benefits.

With few exceptions, regional airports have been in the red for about the past ten years. In 2013, for example, none of the airports discussed in this paper was able to show a profit. As a rule, the loss (before loss transfer) per airport was in the single to double-digit millions range. Half of the regional airports have failed to make any profit since 2005.

The scepticism we voiced in a 2005 report, with regard to expansion plans at regional airports, has since proven to be well-founded. Looking ahead, we remain sceptical. In the future, air traffic in Germany is likely to increase primarily at large airports as well, partly because airlines prefer them and partly because they benefit from ongoing migration to conurbations. However, there is little to suggest that total passenger volume at the regional airports in question will grow (substantially) in the long term. Economic pressure on airport owners (generally public authorities) therefore remains high.

In 2014 the European Commission published its "Guidelines on State aid to airports and airlines". These provide basic guidance as to the types of aid which are permitted, and those the Commission views critically. Although the guidelines leave some room for interpretation, they do present a major obstacle to the financing of regional airports. Justifiably, operating several unprofitable regional airports in the same catchment area is assessed especially negatively. In view of this fact, there is also increasing political pressure on these airports. Most regional airports in Germany will have to improve their financial situation in the coming years in order to avoid long-term/permanent conflict with the EU guidelines.

It would be preferable if the federal government were the competent authority on the fundamental question of whether and where airport capacities should be expanded. This could help to prevent unprofitable overcapacities across the country. Once the "ifs" and "whens" of the issue have been addressed, the downstream regional authorities could take responsibility for operating activities (the "hows"). Such a distribution of tasks would make economic sense and render much of the discussion on regional expansion plans unnecessary.



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1. Introduction and retrospective

About ten years ago, Deutsche Bank Research produced a report on the then trend to expand German regional airports.¹ Expansion plans at regional airports remain a matter of controversy to this day. This analysis examines how the sector has developed in recent years and highlights the special characteristics of individual airports. It also discusses the consequences of changing political and economic conditions on the future of regional airports in Germany.

Definition of regional airports

1

There is no set definition of a regional airport. The German Air Traffic Act differentiates primarily between (passenger) airports and airfields. However, the difference essentially concerns construction aspects.

On its website, the German Airports Association (Arbeitsgemeinschaft Deutscher Verkehrsflughäfen, ADV) states that the ADV and German air traffic authorities use the term "regional airports" for airfields with scheduled public air traffic, if they are not part of international passenger airports. Regional airports can be airports or airfields depending on their operating licence. They are responsible for operating air traffic control using their own personnel and take technical responsibility for this, whereas air traffic control services at international passenger airports are provided directly by DFS (Deutsche Flugsicherung GmbH).

In general, the prefix "regional" is used for airports which have lower passenger volumes and are located away from large conurbations. These airports have traditionally specialised in general aviation, and commercial scheduled and charter flights have either not been offered or only form a small proportion of flight movements.

The 2014 EU "Guidelines on State aid to airports and airlines", which we examine in this report, classify all airports with fewer than 3 million passengers per year as regional airports. However, airports with fewer than 200,000 passengers are largely exempt from these guidelines. We follow this classification and will therefore primarily consider those airports with an annual volume of between 200,000 and 3 million passengers. This range includes Bremen, Dortmund, Dresden and Leipzig/Halle airports, which are located near cities with more than 500,000 inhabitants. The chapter analysing traffic development examines these city airports among the regional airports separately.

Germany has a long tradition of political debate on expanding regional airports and upgrading them to accommodate scheduled air traffic. One important reason for this is that the years following German reunification saw the former occupying powers in Germany withdraw from numerous airports used by the military. Local authorities were then left with the question of how to use these sites. As an essential piece of each airport's infrastructure was already in place, namely the runway, it was only natural for many policy-makers to consider using the former military airports for civil purposes. In addition to these conversion projects, they considered expanding or technically upgrading government-owned airfields used purely for civilian purposes, so they could not only be used for general aviation (e.g. private aviation and air sports, training and rescue flights, commercial flights with small corporate aircraft) but also for commercially scheduled or charter flights. Politicians had to weigh up the required investment in relevant infrastructure and technology (e.g. instrument landing system approach technology) and the anticipated ongoing costs of a larger airport against the potential local effects of added value and job creation, or using fiscal revenues in other ways.

Hahn Airport: a compelling – or deceptive – example

One important reason such investments often appeared lucrative to local political decision-makers was the rapid increase in passenger numbers at the Hahn Airport in the Hunsrück mountains – a classic conversion project. The advantage of this airport was that Irish airline Ryanair had decided back in 1998 to build a major base in Germany there. Ryanair massively increased the number of flights at Hahn Airport over the years. Local passenger numbers grew and jobs were created in the structurally weak region. This development was preceded by important regulatory decisions at EU level. Due to the final liberalisation of European air traffic in 1997, EU airlines could offer flights anywhere within the EU. Liberalisation more or less gave the go-ahead for the "victory march" of the low-cost carriers. As an important provider in this sector, Ryanair took advantage of these new freedoms very early on and very quickly.

Other regions with similar circumstances certainly took note of the increasing passenger numbers and additional jobs at Hahn Airport. Advocates of expansion plans at other regional airports likely felt encouraged to pursue a similar strategy based on the experience of Hahn Airport, although the airport has posted operating losses from the very beginning and continues to do so. In some cases, higher-level regional authorities (e.g. federal states) provided investment grants for applicable expansion projects. It was therefore quite understandable that there was local majority support politically for such projects. However, many critics also voiced their concerns, fearing negative economic consequences for the local communities affected or noise pollution from aircraft.

We can already state that the "success story" of Hahn Airport with regard to local passenger volume has not been repeated (to this extent) at any other regional airport in Germany to date. In view of this fact, the development of

¹ Compare Heymann, Eric and Jan Vollenkemper (2005). Expansion of regional airports: Misallocation of resources. Deutsche Bank Research. Current Issues. Frankfurt am Main.



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Hahn Airport was a compelling but ultimately deceptive example for the political decision-makers who pushed for the expansion of regional airports elsewhere.

Overview of the main criticisms of regional airport expansion plans

We listed a number of fundamental criticisms against the expansion of regional airports in our 2005 report, as well as in subsequent years.² These criticisms can be summarised as follows:

Meagre national economic and transport benefits

— The national economic and transport benefits of regional airports are meagre. This is exemplified by several points. First, Germany already has many international passenger airports which the majority of the population can reach within a reasonable time; there are also foreign airports near the borders. Second, the range of routes for scheduled and charter flights at most regional airports is very small (and usually focuses on traditional holiday destinations). At any rate, extensive expansion of the relevant infrastructure cannot be justified on the grounds of the growing global aviation market. For most routes, potential customers will have to continue to use other airports or small corporate aircraft. Third, this means that the anticipated (transport) benefits supposedly generated for the local economy by a regional airport are generally overestimated. In this context, we must allow that business sites located at a remote distance from an airport can also have advantages (e.g. lower wages and rents compared to those in conurbations with better transport links) and that having an airport nearby is not the most important location factor for most small and medium-sized enterprises. Fourth, it is often argued that expanding regional airports relieves congestion at large airports, but in practice this is almost never the case. Of course, there are examples of a regional airport acting as a relief airport for a nearby major airport with scarce/expensive slots, primarily by taking over flight operations with smaller aircraft. One such example is Egelsbach Airport near the Frankfurt am Main hub. However, in reality there is no observable significant relief function for passenger and freight volume, especially since few German airports suffer from bottlenecks.

Low traffic volume meets high overheads

— Regional airports are also beset with economic problems. It is fundamentally very difficult to operate a regional airport profitably. This is mainly due to the high fixed costs that result from operating the airport. It is very difficult for regional airports to cover these costs from fees due to the low volume of traffic and limited growth potential. The lack of critical mass in terms of passenger numbers is one major reason why private investors in regional airports are the exception. Low passenger numbers mean revenue from non-aviation business is also small (e.g. revenue from retail sales, concessions or parking charges). However, the fact that regional airports are very difficult to operate in an economically viable manner is not primarily a decisive factor in their expansion or existence. Likewise, it is hardly possible to operate local public transport systems and break even. However, compared to regional airports, local public transport provides significantly greater transport and economic benefits – also in relation to its costs. Particularly in major cities, functioning traffic flows are virtually inconceivable without public transport.

The economic difficulties of regional airports therefore pose a problem for their respective owners in particular, because they have to account for investments and any losses in ongoing operations. Since regional airports in Germany are predominantly government-owned (by municipalities and

² It is important to emphasise here that we are not criticising the existence of regional airports themselves. Many (even) smaller airfields fulfil an important function, such as for general aviation. Providing such infrastructure generally falls to the public authorities. Rather, our criticism targets extensive expansion plans for regional airports.



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Job creation argument not economically convincing

Few airlines operate at regional airports

Potentially cutthroat competition between neighbouring regional airports

sometimes federal states), losses come at the expense of the taxpayers. Fiscal revenues used for regional airports cannot be used for other government projects.

- The claim that expanding regional airports will create local jobs is a weak argument. We must continually ask which jobs and value-added effects might have been achieved with other measures. Moreover, it should not be the responsibility of the state to continually create subsidised jobs.
- Another argument against the expansion of regional airports is that only a few airlines have any interest in offering flights at these airports; this applies equally to passenger and freight traffic. The example of Hahn Airport could not be replicated over and over at will. All in all, this means there are limits on the growth potential of the airports concerned. Conversely, individual regional airports can very easily become dependent on only a few airlines or even a single airline. This reinforces the airline's negotiating power against the airport. In the past, airlines were therefore frequently able to negotiate low runway fees, which in turn had a negative impact on the airport's key operating figures. Then, if traffic figures did not develop as the airlines expected, they often quickly stopped using that airport.
- If two or more regional airports are located close to one another, their catchment areas will overlap and they will target the same potential customers. This can trigger cutthroat competition or cannibalisation effects. In Germany, there were/are examples of neighbouring regional airports being located in different federal states (e.g. Memmingen and Friedrichshafen, Kassel and Paderborn/Lippstadt, Saarbrücken and Zweibrücken). The criticism in these cases is that any expansion plans are inadequately coordinated between the respective federal states. As early as 2005, we advocated returning more responsibility for planning airport infrastructure to the federal government in order to avoid redundant capacities. Despite corresponding statements of intent at federal level, in established practice nothing has changed since then.

On balance, criticism of regional airport expansion therefore concerns (higher-level) transport, economic, operational and ultimately political factors.

2. Development of regional airports mostly disappointing

This chapter examines how regional airports in Germany have developed in recent years. We focus on the traffic volume and restrict ourselves to those airports that have long records tracing the development of local passenger numbers. In addition, we briefly discuss planned or implemented investment projects for selected airports, key operating figures and changes in the ownership structures.

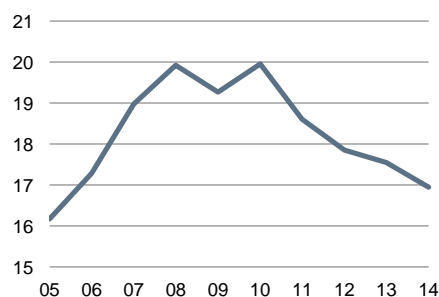
2.1 Traffic volume at regional airports trending downward of late

Since 2005, growth in traffic volume at regional airports in Germany has been characterised by a two-tier development phase. From 2005 to the end of the last decade, the total number of passengers at the airports analysed³ tended to rise, reaching a peak in 2010 at some 20 million passengers, or growth of a good

Two-tier development

2

Passenger volume at German regional airports*, millions



* According to definition in footnote 3 of this report

Source: ADV

³ These are Bremen, Dortmund, Dresden, Erfurt, Friedrichshafen, Hahn, Karlsruhe/Baden-Baden, Leipzig/Halle, Münster/Osnabrück, Niederrhein/Weeze, Paderborn/Lippstadt and Saarbrücken. To have a level basis for comparison, we disregarded traffic numbers from several regional airports. This applies to those airports which had no (noteworthy) scheduled or charter flights in 2005 (e.g. Allgäu Airport Memmingen), where there are now no commercial scheduled or charter flights (e.g. Altenburg-Nobitz, Zweibrücken), whose traffic volume in 2014 was less than 200,000 passengers (e.g. Kassel, Lübeck, Rostock-Laage) and finally every airport for which we do not have traffic volume figures for all years under consideration.

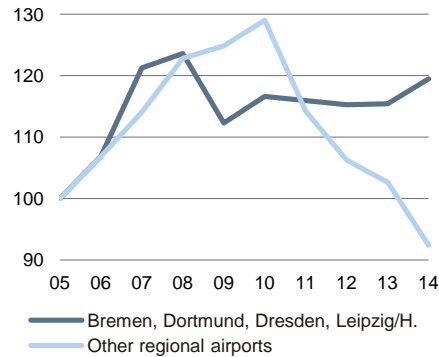


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City airports fare better

3

Passenger volume at German regional airports*, 2005=100



* According to definition in footnote 3 of this report

Source: ADV

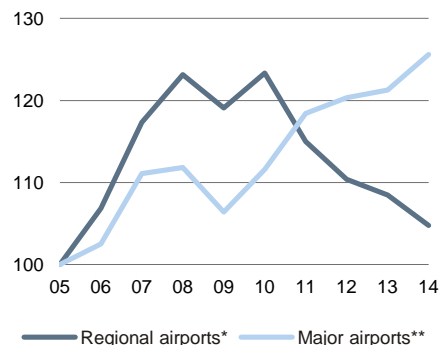
23%. New (price-sensitive) customer groups could be accessed thanks to the additional offer of new, cheap flights. In contrast, from 2010 to 2014, traffic volume decreased by 15%, meaning last year's level exceeded the 2005 level by barely 5%.

A differing picture emerges in another respect. It is noticeable that airports in cities with over 500,000 inhabitants (Bremen, Dortmund, Dresden and Leipzig) fared better on average with regard to passenger volume during the given period than the other airports, which are located near cities with considerably fewer inhabitants or in more rural regions. The passenger volume of Bremen, Dortmund, Dresden and Leipzig airports – if you like, the city airports among the regional airports – exceeded the 2005 level by 19% in 2014. In fact, there was a drop compared to the 2008 peak. However, at -3%, the decline was quite small. At the other regional airports examined here, passenger volume in 2014 was almost 8% below the 2005 level and about 25% below the 2008 level. Bremen Airport is the only one of the regional airports examined here for which 2014 was also the year with the highest passenger volume; at all the other airports, the peak to date had already been reached in previous years. With regard to freight volume, the positive growth at Leipzig Airport deserves a mention.

Passenger volume at regional airports has been falling for several years

4

Passenger volume at German airports, 2005=100



* According to definition in footnote 3 of this report

** Airports with more than 3 million passengers per year

Source: ADV

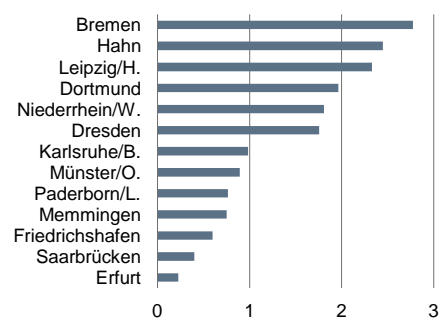
Larger airports grow significantly faster

A comparison with traffic volume at larger and major German passenger airports with more than 3 million passengers per year shows that regional airports have clearly grown far less dynamically in recent years. Between 2005 and 2014, passenger volumes at major airports increased by 26%. Compared to 2008, growth was still at 12%. Passenger volumes at major airports hit a new record in 2014. In any case, traffic volume during the entire period under consideration only decreased in 2009, a year of recession. The comparison illustrates an interesting detail: until around the end of the last decade, regional airports achieved a higher growth rate in their passenger numbers. Then the curve began its downtrend, while the major airports continued to show a fundamental uptrend. Among the major airports, Berlin, Dusseldorf, Munich and Hamburg showed the highest increases in passenger volume. Volume at Frankfurt Airport would have increased more quickly had it not suffered capacity bottlenecks prior to the opening of the new runway (2011). Nuremberg and Hanover airports fared significantly worse; they have the lowest passenger volume of the major airports.

Bremen on top

5

Passenger volume at German regional airports*, 2014, millions



* Airports with a passenger volume of between 200,000 and 3 million per year; for reasons of improved legibility, the full airport name was not used.

Source: ADV

The absolute passenger numbers at German airports explain the overall low impact of regional airports on the total German air traffic market: in 2014, all of the regional airports considered in this paper combined had just 17 million passengers; the peak came in 2010 at almost 20 million passengers. By comparison, Frankfurt Airport saw almost 60 million passengers in 2014. The share of the regional airports in total traffic ran to just over 8%.

Multiple factors cause low dynamics at regional airports

There are four main reasons for the disappointing development of passenger numbers at regional airports in Germany, and these are definitely connected:

- Regional airports saw their first noticeable setback in the recession year 2009, when traffic numbers fell by just over 3%. However, the fall at major airports was even greater at almost 5%.
- The introduction of aviation tax in Germany at the beginning of 2011 was especially drastic. Offerings from low-cost carriers dominate at regional airports, so their customers are more likely to be price-sensitive. The relative surcharge for the flat tax on the ticket price is highest in the price-

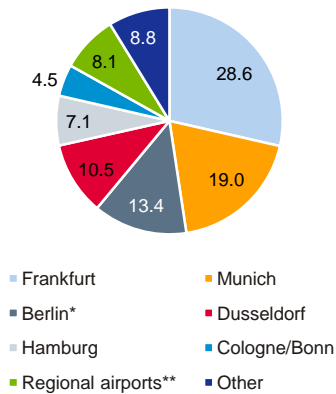


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Low passenger volume at German regional airports

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Passenger volume by airport in Germany, 2014, %



* Schönefeld and Tegel
** According to definition in footnote 3

Source: ADV

sensitive low-cost sector, which has a negative effect on demand. What is more, the proportion of business travellers is greater at larger airports than at regional airports, and their demand for tickets is less price-elastic. Aviation tax caused some airlines to reduce their services at regional airports and/or switch to foreign airports in neighbouring border areas. In total, passenger volume at regional airports decreased by some 7% in 2011, but increased by about 6% at major airports. Although the aviation tax was a one-off measure, the after-effects are still being felt at the regional airports.

- Another development linked to aviation tax has had a negative impact on traffic numbers at regional airports in recent years. This is the trend of low-cost airlines gradually reducing their services at many regional airports and instead offering more flights at larger airports. Among the regional airports too, supply-side traffic flows have shifted from airports in rural areas to the city airports mentioned above. This development particularly applies to Ryanair, which currently also offers flights at larger airports such as Hamburg and Cologne. Most of the other major airlines in Germany have always focused predominantly on larger airports anyway.
- The fourth reason is that the low-cost business in Germany and Europe as a whole has lost momentum in the recent past, compared to the first few years after the liberalisation of the European aviation market. In the meantime, the business models of individual airlines (scheduled, low-cost and charter carriers) have become more similar. For example, traditional scheduled airlines also offer a certain number of cheap tickets. Flights offered by the Lufthansa subsidiary Germanwings, as well as a large proportion of Air Berlin flights, are designated cheap flights in the Low Cost Monitor published every six months by the German Aerospace Centre (Deutsches Zentrum für Luft- und Raumfahrt, DLR). Air Berlin still also continues to offer long-haul (intercontinental) routes. For many regional airports, it is disadvantageous that competition between airlines takes place primarily at the larger airports.

Airports close to conurbations benefit from migration to economic centres

In summary, it should be noted that passenger numbers at regional airports in Germany have developed more poorly in the last 10 years than at larger airports. In our view, nothing will likely change in this regard in the coming years, especially since the major German cities benefit from (intra-German) migration, while the population in many rural areas is noticeably shrinking. The freight business, which we only discuss peripherally here, does not currently play a major role at most smaller airports, nor will it in the future. It depends on bundling effects even more than passenger traffic.

2.2 Investments in regional airports: Different developments

Since German reunification there has been very substantial investment in some cases to expand a number of regional airports, targeting terminals, baggage handling facilities, runways and technical equipment, among others. At other airports, in contrast, similar investment plans were discussed for many years but ultimately abandoned. In addition, there are still quite a few regional airports that have plans for expansion but which have not yet implemented them. This report cannot cover all of the expansion investments that have been implemented, planned or eventually abandoned at regional airports in Germany in the last 25 years.

Allgäu Airport in Memmingen: One of the most recent examples of expansion measures

One example of recent major expansion investment can be seen at Memmingen Airport (Allgäu Airport). Both local private businesses and public authorities invested in this classic conversion project; the financial involvement of local private businesses in the project is generally to be welcomed. After the inception of commercial traffic at the airport in 2007, passenger numbers initially increased strongly and hit a new record in 2010 at around 910,000 passengers.



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However, the volume dropped in 2013 and 2014. Additional expansion measures at the airport (a wider runway) and their financing are currently under discussion. The example of Memmingen illustrates the competition between individual regional airports and the market power of the airlines against smaller airports: Ryanair stopped its service to neighbouring Friedrichshafen Airport and "switched" to Memmingen.

The best-known "expansion measure" at a regional airport is the new construction of Kassel Airport (previously Kassel-Calden). This airport began operating in 2013. The costs of the new construction amounted to around EUR 270 million, with the State of Hesse assuming the majority of the costs. The investment project was subject to criticism, not least because of the proximity of the new airport to the airport in Paderborn/Lippstadt. To date, passenger numbers have remained below 50,000 per year, with predominantly tourist destinations being served. Business travel services (with small aircraft) are currently more important than scheduled and charter flights.

Scheduled services dropped and expansion plans unimplemented at some airports

Some regional airports have discontinued scheduled services

At some regional airports, investments were made to expand the infrastructure over the course of the last decade. One goal was to make the airport more appealing to providers of scheduled and charter flights, and in some cases airports were actually successful in attracting airlines for several years. However, the lack of demand or disappointing demand (from passengers and airlines) and continuing severe losses frequently resulted in the owners of the respective airports opting to discontinue scheduled services. Examples of this are Altenburg-Nobitz and Magdeburg-Cochstedt. Examples of planned (extensive) expansion projects that were ultimately abandoned by owners and/or potential investors or not approved by the government are the airfields in Bitburg, Hof-Plauen and Mönchengladbach.

2.3 Operating losses are the order of the day – public authorities remain the primary owners

Regional airports predominantly generate losses

Many regional airports publish their key operating figures annually in the Federal Gazette (e.g. balance sheets and profit and loss statements). The last available figures date from 2013. Analysis of the key operating figures for the airports in our sample shows a relatively clear outcome: almost without exception, the annual results of the airports have been negative for the last ten years or so. In 2013, not one regional airport produced a positive result. As a rule, the loss per airport was in the single to double-digit millions range. In 2013, the cumulative loss (before loss transfer) for Bremen, Dortmund, Dresden, Erfurt, Friedrichshafen, Hahn, Karlsruhe/Baden-Baden, Kassel, Leipzig/Halle, Memmingen, Münster/Osnabrück, Niederrhein/Weeze, Paderborn/Lippstadt and Saarbrücken was around EUR 144 million according to the Federal Gazette. At the very top of this list was Leipzig/Halle Airport, with a loss before loss transfer of EUR 49.7 million. Half of the airports examined in this report have failed to show any profit since 2005.

High costs of capital

The objective of this report is not to discuss the key operating figures of the airports in detail. However, in many cases an appreciable proportion of the losses can be attributed to the high costs of capital these airports incur (depreciation and financing costs), some of which stem from earlier investments. While some airports do manage to be profitable (in some years) in terms of operational business (i.e. solely in flight operations), the low value of runway fees and passenger numbers coupled with sizeable flight operation overheads mean operating earnings are generally insufficient to cover all of the costs,



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including depreciation and financing costs. The profit and loss statements of some airports do show a transfer of the loss (by the owner(s)), which is thus formally offset. But, ultimately, losses are also borne by the owners in those cases where no explicit loss transfer is reported in the profit and loss statement.

When measured against total tax revenue in Germany or the costs of large infrastructure projects, the stated losses per airport are relatively small. Nevertheless, annually recurring shortfalls can mean painful burdens for the public budget of the respective owners (municipalities). Money spent on regional airports is not available for other public services (such as education). In addition, the often small number of flights means local transport benefits are minor.

Many expert opinions sought on value-added effects of regional airports

In recent years, there have been many reports by experts calculating the value-added effects of regional airports for the respective local economy. Many of these reports conclude that the operating losses of the (expanded) regional airports would be more than offset by the positive value-added effects for the individual regions. However, the conclusions of such reports greatly depend on which assumptions are made about (future) passenger volume, the local expenditures of incoming passengers, job effects, the average income of the employees and any multiplier effects.

Net effect of imported and exported purchasing power is decisive

Many of these opinions were too optimistic with regard to the expected passenger volume. Furthermore, the expenditures of incoming passengers in each region were frequently not compared with the respective loss of purchasing power which results from people from the region flying abroad and consuming at their destination. The net effect of "imported and exported purchasing power" is therefore decisive. Since many regional airports offer flights to traditional holiday areas around the Mediterranean Sea, it is entirely plausible that so-called outgoing tourism at these airports is ultimately more relevant than incoming tourism.

Which *additional* effects do regional airports trigger? Which alternatives could there have been?

In order to examine the economic effects of incoming passengers/tourists on the local economy, we must continuously ask ourselves how many of these visitors came because of the airport alone and would otherwise not have travelled to the region. Is this indeed mainly an issue of additional visitors? Or would many of the people have travelled to the respective region using another mode of transport if the airport had not existed or if a suitable flight had not been available? Pertinent questions also need to be asked about the creation of airport-related jobs: what proportion of these jobs can be directly attributed to flight operations? And which employees simply work for businesses that happen to be near the airport but have little or nothing to do with actual airport operations (or any potential expansion thereof)? Could more beneficial effects on the local labour market have been achieved with other measures?

From our perspective, many of the expert opinions failed to adequately differentiate between the aspects outlined above. In this respect, the calculated positive value-added and job effects for the respective regions generally appear to be excessively high.

Public ownership dominates

Private businesses own stakes in regional airports only in rare cases

We have already mentioned that operating losses are mostly borne by public authorities as almost all regional airports are owned by federal states and/or municipalities. Attempts have been made in the past to involve private businesses as investors or owners as well. However, most of these attempts were unsuccessful in the long term, or private businesses withdrew from the projects (e.g. Fraport AG sold its shares in Hahn Airport to the State of



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Rhineland-Palatinate in 2009). Even in cases where private businesses were the owners of, or investors in, regional airports or are still active today, state subsidies for investments or ongoing operations were/are still frequently needed. Due to the difficult business prospects of regional airports, the ownership structure is not expected to shift further towards private involvement in the coming years. The future of these airports therefore also depends on the considerations and budgetary leeway of local political decision-makers.

3. Increasing political pressure on regional airports

EU guidelines provide guidance on aid to airports and airlines

Changes in the political environment may bring pressure to bear on the business model of regional airports in the years to come. On the one hand, the European Commission's "Guidelines on State aid to airports and airlines" published in 2014 provide guidance on which airports will be entitled to support from the state in the future and to what extent.⁴ On the other hand, the debate surrounding Germany's debt brake might cause many state owners of regional airports to reconsider their current subsidy policy.

EU guidelines define framework for financing smaller airports

Business model of individual regional airports has long been the focus of the Commission

The Commission has been examining contracts between regional airports and airlines over the last ten to 15 years in some cases. Criticisms included (excessively) low runway fees and airport subsidies to selected airlines for introducing new routes (marketing support). The Commission also launched several legal proceedings in this respect, which we will not detail in this report. However, in essence these proceedings were based on the suspicion that state-operated airports preferred certain airlines over competitors by granting them low fees and/or subsidies, thereby distorting competition in the industry.

Investment aid

The smaller the airport, the larger the potential investment aid from the state

The Commission's goal in implementing the above guidelines is to regulate aid practices in aviation. The Commission differentiates between investment aid and operating aid for airports. *Investment aid* is for financing capital assets and can cover respective funding gaps. In principle, the following rules apply to this type of aid:

- The maximum aid intensity depends on an airport's passenger volume.
- For airports with an annual volume of 3 to 5 million passengers, investment aid may be up to 25% of the investment costs eligible for aid.
- Airports with a passenger volume of 1 to 3 million per year can be supported with a maximum of 50% of the investment costs.
- For airports with fewer than 1 million passengers per year, aid intensity can be up to 75% (whereas airports with fewer than 200,000 passengers are in principle not subject to the above-mentioned guidelines but rather come under the general state aid regulations of the EU).

The guidelines also specify aid measures, which must always be registered in advance with the Commission. This concerns, among other things, investment aid for airports with more than 3 million passengers, airports with fewer than 1 million passengers per year if aid intensity exceeds 75%, new airports or investment aid for airports that are located within a periphery of 100 kilometres or less than one hour's drive from another airport.

⁴ See European Commission (2014). Communication from the Commission – Guidelines on State aid to airports and airlines. Official Journal of the European Union. 2014/C 99/03. Brussels.



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Operating aid

Operating aid should only be possible for a transitional period of ten years

Unlike investment aid, *operating aid* is intended to cover financial gaps in the airport's operational business. Here too, the guidelines provide for certain regulations. Operating aid should only be granted to airports with a passenger volume below 3 million per year. The Commission assumes in its guidelines that larger airports can usually cover their operating costs themselves. For smaller airports, operating aid should only be granted for a transitional period of ten years (as of April 2014). This should be at most 50% of the average operating costs of the entire period. For smaller airports (up to 700,000 passengers per year), the maximum investment aid for the first five years after the start of the period can be up to 80%. By implication, these regulations mean that all airports must cover their operating costs entirely themselves after the transitional period of ten years. Pursuant to the guidelines, aid measures must also always be registered in individual cases if the operating aid is to be granted to airports that are located within a periphery of 100 kilometres or less than one hour's drive from another airport.

Guidelines pose obstacles to the financing of regional airports ...

Business model must be based on a more solid foundation

If the guidelines outlined above are vigorously followed in the years to come, they will represent a major obstacle to the financing of regional airports. The respective competent regional authorities that grant aid will have to reassure themselves in the future that the airports they are supporting will be able to earn a significant part of their costs of capital, as well as covering their operating costs in the long term. Moreover, it might become necessary to increase fees for airlines, attract new airlines as customers, tap into new and alternative sources of revenue and/or introduce rationalisation measures. Although such measures do in essence have the potential to improve the economic situation at smaller airports, the uncertain and/or negative transport industry prospects of many airports could nevertheless reduce the willingness of their owners to provide (further) aid.

Aid for neighbouring (unprofitable) airports is viewed especially critically

It is noticeable that the EU guidelines are in many instances firmly against aid for neighbouring airports. This is demonstrated by the following quotations:

- "Nevertheless, the duplication of unprofitable airports or the creation of additional unused capacity does not contribute to an objective of common interest."⁵
- "In particular, the duplication of unprofitable airports or the creation of additional unused capacity in the catchment area of existing infrastructure might have distortive effects. Accordingly, the Commission will, in principle, have doubts as to the compatibility of investment into airport infrastructure at an airport located in the catchment area of an existing airport where the existing airport is not operating at or near full capacity."⁶

Ultimately, such statements clarify the aim of preventing overcapacities at regional airports and/or cannibalisation effects between neighbouring airports. Too high an airport density will ultimately harm all market participants, which is why we consider the guidelines to be going in the right direction.

⁵ European Commission (2014). Loc. cit. Point 85.

⁶ European Commission (2014). Loc. cit. Point 106.



Germany's regional airports under political and economic pressure

... but a certain degree of flexibility will remain

Time-limited marketing support
remains possible in principle

Despite clear regulations, the Commission's guidelines do have a certain degree of flexibility. Of course, they do not question the existence of regional airports – quite the opposite. The Commission states that "regional airports can prove important both for local development and for the accessibility of certain regions".⁷ Furthermore, the Commission states in its guidelines that "under certain conditions, certain categories of aid to regional airports and airlines using those airports can be justified, in particular to develop new services and contribute to local accessibility and economic development."⁸

In the end, regional airports and their owners will still have the option to promote local investment and flight operations in the future. Marketing support to airlines, for example, which is designated as start-up aid in the guidelines, is not considered to be operating aid and can be paid to airports with fewer than 3 million passengers for up to three years. Furthermore, support for tasks at airports falling within the public policy remit (e.g. police, fire brigade, customs) is not classified as state aid. The guidelines outlined above do not apply to small airports with fewer than 200,000 passengers per year and (small) airports in the outermost regions; rather, the general state aid regulations of the EU apply in these cases. This provides the respective owners with a bit of room for manoeuvre.

The individual case will be decisive

Guidelines leave room for
interpretation

In the end, the Commission's guidelines do not threaten the short-term existence of regional airports in Germany (or Europe). After these guidelines were published, individual airports stated that they were unaffected by these regulations or that aid for the respective airports was covered by the guidelines. One advantage of the guidelines is that future permissible types of aid have now been clearly established. This gives political decision-makers clear guidance in advance. However, the guidelines leave much room for interpretation. How exactly these limits will be interpreted by owners and by the Commission (and their respective legal counsel) when it comes to designated (planned) aid for investment in infrastructure or flight operations alone is sure to depend greatly on the individual case.

However, it has essentially become apparent that most regional airports in Germany will have to improve their financial situation in the coming years to be able to avoid long-term/continuous conflict with the EU guidelines. Given recent decreasing passenger numbers at those airports and unfavourable prospects for future traffic development, however, the airport operators will have a difficult time increasing their revenues. The high proportion of fixed costs in airports means potential cost-saving measures are also limited at least in the short term; however, in the long term, all costs are variable. It therefore seems plausible that many owners will abstain from making large investments in particular. This will likely apply especially to regional airports near other airports, as the guidelines focus explicitly on them. The respective owners could in fact refer directly to the EU requirements to justify such an approach politically. Responsibility for a local, possibly unpopular decision (no airport expansion, dropping a regular service and focusing on general aviation, or capacity downsizing) could thus be passed in part to the EU. Ultimately, the guidelines will have an overall positive effect if they prevent overcapacities occurring in the airport infrastructure in individual regions. They will increase regional airport owners' awareness of the chance of long-term economic success of investment measures.

⁷ European Commission (2014). Loc. cit. Point 9.

⁸ European Commission (2014). Loc. cit. Point 12.



Germany's regional airports under political and economic pressure

Debt brake increases political pressure

Debt brake likely to influence spending by downstream regional authorities

Irrespective of the Commission guidelines, domestic political developments are likely to make it more difficult to finance regional airports in the years to come. Given that the debt burden faced by many regional authorities (not just in Germany) has been growing for years, preventing and/or reducing debt has gained political majority appeal in Germany in recent years. This culminated in the debt brake for the federal government and for some federal states. Regardless of the practicalities of imposing these debt brakes, they highlight the desire for balanced public budgets. Debt brakes for the federal government and states also have an indirect effect on municipal budgets, which are partly funded by tax revenues from the higher-level regional authorities.

If political decision-makers want to avoid future debts, the issue more than ever will be to distinguish between truly essential public expenditures and those which are (politically) desirable but would overburden available finances. Ultimately, the financial scope for subsidies and grants of all types will be reduced. Therefore, state and municipal expenditures on regional airports could be scrutinised more closely than ever before.

4. Conclusion and outlook

Our fundamental scepticism ten years ago was justified

The scepticism we first voiced in our report ten years ago with regard to (extensive) expansion plans at regional airports has since proven to be well-founded. Passenger numbers at most airports have followed a disappointing downtrend in recent years. The range of available flights remains limited, creating few positive effects on local economies. From a business standpoint, most regional airports have generated operating losses.

Regional airports classed as city airports have somewhat better outlook for traffic volume

What are the chances of something fundamental changing in this situation? In our view, air traffic in Germany will continue to grow primarily at major airports in the future, not least because these airports are preferred by the vast majority of airlines and because demographic development favours airports in the vicinity of large conurbations. If bottlenecks develop at these major airports, the government should start planning for expansion, where it is possible and useful to do so, early on. Although some individual regional airports might routinely report rising passenger numbers over a certain period, the city airports among the regional airports have a better chance of success. However, there is little to suggest that total passenger volume at the regional airports in question will grow (substantially) in the long term. Any additional regulatory pressures on the industry, including those potentially driven by climate change policy, will likely affect smaller airports even more than large airports.

Policy rethink likely

Given this outlook, it is unsurprising that we remain critical of extensive expansion plans at regional airports. However, we anticipate that local political decision-makers will approach projects like these more carefully in the future. This argument is backed by the Commission guidelines, which pose greater obstacles to the funding of regional airports. Furthermore, local governments will probably learn from the negative experiences of projects in other regions and will not (or no longer) argue that their situation is entirely different (much better). The debt brake will presumably also foster this mindset. However, widespread closings of regional airports are unlikely in the near future. In the medium to longer term, it seems realistic that more public-sector owners of regional airports will work towards withdrawing from the scheduled and charter flight business, and will instead concentrate more on general aviation flights where regional airports undoubtedly have an important part to play. Even ten years from now, however, there are certainly still likely to be regional airports offering scheduled and charter flights.



Germany's regional airports under political and economic pressure

More federal authority would help and make economic sense

It would (still) be preferable if the federal government were the competent authority on the fundamental question of whether and where airport capacities should be expanded. This could help to prevent unprofitable overcapacities, which were justifiably assessed so critically by the EU guidelines, across the country. A striking comparison with the German motorway system illustrates this argument: no one would advocate the construction of a new motorway parallel to an existing one that is not being used to capacity. Once the "ifs" and "whens" of the issue have been addressed, the downstream regional authorities could still take responsibility for operating activities (the "hows"). Such a distribution of tasks would make economic sense and render much of the discussion on regional expansion plans unnecessary.

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