



5 November 2009

INFORMATION FOR THE CONSULTATION ON THE REVIEW OF THE DOMESTIC AND INTERNATIONAL PASSENGER SECURITY CHARGES 2009

1. Purpose

- 1.1 To consult with the Board of Airline Representatives New Zealand (Inc) (BARNZ), the airline industry and Government departments on a proposal by the Aviation Security Service (Avsec) to review the current domestic and international passenger security charges. This document will be discussed in detail at formal consultation meetings.

2. Background

- 2.1 Avsec is an operational organisation of about 791 full-time and part-time staff (752 full-time equivalents). Under the Civil Aviation Act 1990, Avsec is responsible for the screening and searching of departing international passengers and their baggage for prohibited and dangerous items, liquids, aerosols and gels; airport access control; airport worker screening; patrolling of security-designated areas; and the searching of aircraft. Avsec also screens domestic passengers and their hand baggage on domestic aircraft of 90 seats or more.
- 2.2 Avsec currently operates at six airports – Auckland, Hamilton, Wellington, Christchurch, Dunedin and Queenstown and is soon to commence screening of international flights from Rotorua Airport.

Passenger security charges

- 2.3 Following the funding review of passenger security charges in 2004/05, Cabinet decided that Avsec should continue to be one hundred percent industry-funded by way of a charge on airlines for both domestic and international passenger departures (the charges) which are to fund the maintenance and operations of Avsec.
- 2.4 In addition, it was also agreed that any cost increases as a result of changes to services quality and standards should be funded by whoever requests, or is the primary beneficiary of, the new service and that new services should be funded on the same basis as existing services.
- 2.5 The Civil Aviation Charges Regulation (No 2) 1991 sets out the basis on which the charges are made.
- 2.6 Under the direction of Cabinet, Avsec is required to set fees that meet the full costs of the services provided (i.e. it should not set charges at a level that deliberately generates a surplus or a loss, given the Cabinet directive that Avsec be one hundred percent industry funded). Guidance on this is provided by Treasury's Costing and Charging Guidelines and the International Civil Aviation Organisation's (ICAO's) Policies on Charges for Airports and Air Navigation Services.

- 2.7 In adopting this approach, Avsec needs to manage its financial risk by avoiding setting charges too low or too high. Avsec aims to set charges for a three-year period. This is consistent with “Charging Fees for Public Sector Goods and Services” (2008), produced by the Office of the Auditor-General and “Guidelines for Setting Charges in the Public Sector” (2002), produced by the Treasury. By setting charges over a three-year period, Avsec expects that the charges will balance out over that period.
- 2.8 Surpluses and deficits do arise and are tracked against forecasts through Avsec’s memorandum accounts, with the aim of balancing revenue and expenditure over time, and bringing transparency to the charging system. The use of memorandum accounts also assists in avoiding re-setting the charges too often as frequent adjustments to the level of the charges is not ideal. This approach has been reflected in the proposed new charges.
- 2.9 The current charges were set in 2007 with a proposed review after three years. The review and re-setting of these charges was scheduled to commence in April 2010, with the new charges coming into effect in late 2010.

Establishment of reserves

- 2.10 In 2007, agreement was reached with industry and government for Avsec to establish a reserve of \$3m from the domestic passenger security charge, and \$4.5m from the international passenger security charge (the reserves) to provide funding for Avsec to deal with the initial impact of a significant operational or financial risk associated with a terrorist incident or an international shock (paragraph 3.10 refers). Access to these funds required the Aviation Security Service Board approval.

Over-recovery of charges

- 2.11 It became apparent in 2008, that Avsec was recovering by way of passenger security charges funding in excess of its projected expenditure as originally forecast in 2007. As at 30 June 2009, Avsec had an accumulated surplus of \$26.169m (comprising \$22.847m from the international passenger security charges, \$4.397m from the domestic passenger security charges and -\$1.075m from other fees and charges), excluding the reserves (paragraph 2.10 refers).
- 2.12 As a result of Avsec’s accumulated surplus being larger than forecast, the Government has agreed that the review of the charges should commence now, instead of April 2010, with the new charges coming into effect as soon as possible.

Consultation paper

- 2.13 This paper is intended to be the basis for consultation with industry. It outlines a number of options for utilising part or the entire accumulated surplus for consideration during the consultation process. This paper also outlines the cost pressures and risks Avsec is facing, and the methodology and analysis Avsec has undertaken to identify the options presented.

3. Reviewing and Resetting the Passenger Security Charges

Summary

- 3.1 The proposed passenger security charges have been calculated in line with the Government’s previously signalled intention that industry is to incur the full costs of providing aviation security. This includes Avsec’s full operational costs including capital assets by way of depreciation charge, capital charge and finance costs.
- 3.2 Capital expenditure is not funded directly by industry; Avsec capital expenditure and capital funding is provided through the Government appropriation process. In addition, Avsec has approval from the Minister of Finance to enter into finance leases for the supply of specialised screening equipment as the need arises.

- 3.3 The proposed charges set out in the options below have been calculated on a four-year average basis and seek to recover the full costs of providing international and domestic aviation security by Avsec over the four-year financial period 2009/13.
- 3.4 This four-year financial period has been adopted for ease of calculation purposes, as it is assumed that the new charges will not come into effect until in April 2010, and that surpluses will continue to accrue on the international passenger security charge until this date. In calculating the revised charges Avsec has taken account of the accumulating surplus through to March 2010 and, accordingly, it is appropriate that we also take into account the costs associated with this period.
- 3.5 Despite this calculation period and in accordance with Treasury guidance, the charges will again be reviewed, and possibly reset, in three years (31 March 2013) unless determined at an earlier date.

Background

- 3.6 International and domestic aviation security requirements have continued to significantly increase since 11 September 2001. Over the past eight years, Avsec has substantially increased its security function including the implementation of domestic security screening, international hold baggage screening, a full explosive detector dog (EDD) function, screening for liquids, aerosols and gels (LAGs) and the screening of airport workers.
- 3.7 Since the current charges were set in 2007, Avsec has seen continuous change in airport infrastructure development, major airline carriers entering and withdrawing from the market, airports gaining and losing jet and international services with associated changes to flight schedules, and extreme volatility in passenger projections through increased competition and a global economic downturn.
- 3.8 The aviation security environment is essentially one of rapid change propelled by international events.
- 3.9 Avsec has responded to these events, while continuing to fulfil its domestic and international obligations in a fiscally responsible manner. In this regard, Avsec has delayed and curtailed its expenditure in line with the changing demand for services, delayed and re-phased airport infrastructure development, the opening and closing of airports and airline changes to flight schedules. The resulting effect has been an over-recovery in the international and an under-recovery in the domestic passenger security charges, both of which are most appropriately addressed through the review and possible resetting of these charges.

Establishment of reserves (for a significant event or crisis)

- 3.10 The risks faced by Avsec are two-fold:
- Operational risks, where Avsec needs to deploy additional staff and equipment to undertake extra security requirements; and
 - Financial risks, stemming from the direct costs of undertaking these additional services without any or with little associated revenue.
- 3.10.1 Such risks, whilst acknowledged as unpredictable both in size and nature, commonly stem from an international crisis (e.g. an aviation-related terrorist incident), and generally have an immediate impact requiring an immediate response.
- 3.10.2 To aid in the management of this risk, agreement was reached with industry in 2007 for Avsec to establish a reserve of \$3m against the domestic passenger security charge, and \$4.5m against the international passenger security charges (the reserves).
- 3.10.3 The reserves of \$7.5m have been fully established and remain intact. The reserves are designed to cover increased services, or reduced revenue in response to a specific and sudden security incident for an initial period of six to eight weeks, This encompasses

real but non-quantifiable risks which are excluded from the passenger security charge setting process and might include, for example:

- Increased risk associated with a major event in New Zealand, e.g. the 2011 Rugby World Cup;
- The spread of an international virus (e.g. second wave of H1N1) which may cause an unexpected major decline in passenger volumes; and
- A significant new international 'shock' e.g. an aviation-related terrorist incident, leading to immediate additional security requirements and/or change in passenger travel habits.

3.11 The reserves are intended to provide for a short period of time the funding for Avsec to manage the initial impact of such an event while a more structured, long-term operational and funding solution is developed, if required.

Unfunded operational / financial risks

3.12 Other more immediate unfunded operational risks faced by Avsec which are not covered by the existing reserves, or taken into account in this review of the passenger security charges, and which are able to be funded out of the accumulated surplus, are being put forward for consultation. These include:

- Financial risks associated with the start-up and restart of new domestic and/or international airport facilities, or the major redevelopment of an existing facility.

In these cases where an airline decides to commence operations from an airport at which Avsec does not have a presence, Avsec has an obligation under section 80 of the Civil Aviation Act to attend and screen those passengers. This process would generally involve the transportation of both staff and equipment to fulfil the required functions to the airport concerned. Where the requirement for screening is ongoing (seasonally or otherwise) the purchase of additional equipment (including redundancy equipment) to support the operation, in addition to the recruitment of additional staff, would be required.

Likewise where an airport expands its operations, or undertakes infrastructural changes, these changes could and often do have a direct impact upon Avsec's staffing and equipment requirements, through reduced flexibility in the deployment of staff or changes to the queuing of passengers resulting in greater peaks and troughs or throughput (ie free riders)¹.

In most instances the resulting increased operational costs to Avsec will generally exceed the applicable incremental revenue received.

- Financial risks associated with the replacement of hold baggage screening (HBS) equipment by December 2013.

Work will commence early 2012/13 to replace Avsec's HBS equipment across the country. This equipment is currently subject to a four-year lease expiring December 2009. This lease will be renewed for a further four-year term. Concurrent with this renewal, the equipment will undergo a major refurbishment. At the conclusion of this extended term in 2013, the equipment will be eight years old and beyond its useful economic and technological life.

Replacement equipment, currently estimated at \$22.0m if finance leased at a 9.95% finance rate, would have an average annual ownership costs (depreciation and finance cost) of \$3.922m. These costs will increase the international passenger security charge by an average of \$0.81 per passenger over an estimated eight-year economic life of the asset.

¹ Free riders are passengers who are travelling on services that do not require screening but, due to airport configuration, are required to be screened as they are entering a security designated area and where they mix with other screened passengers.

By comparison, when viewed on a three-year passenger security charge review basis, the charge would need to be \$0.97, \$0.80 and \$0.65 in each of the three, three year charging cycles, based on forecast international passenger numbers.

Part of the international passenger security charge accumulated surplus could be held and utilised to assist defray the first three years' increase operational costs associated with this equipment replacement.

- The implementation of a technological solution for the screening and detection of liquids, aerosols and gels (LAGs).

Screening for LAGs is the biggest single negative issue facing international passengers, airlines, airports and Avsec since its commencement in April 2006. New screening technology in the near future will resolve this by screening for explosives in passenger LAGs, and thus not requiring the passengers to automatically give up their LAGs items at the screening point. When this equipment becomes available Avsec needs to be sufficiently operationally funded to be able to implement and appropriately fund this technology, or run the risk of being out-of-step with the rest of the world. It is Avsec's view that this technology will become available within this charging cycle and that the international passenger security charge surplus is the most appropriate mechanism to provide operational funding for such an investment.

- 3.13 Avsec is of the view that while any or all of these risks/initiatives above could have been built into the international passenger security charge, it would be inappropriate to do so, given the timing uncertainties around them. For transparency reasons, Avsec believes that these costs and their timing are more appropriately managed through the accumulated surplus held within the respective passenger security charge memoranda account balance rather than being built into the underlying passenger security charges as this would lead in turn to further over-recoveries if the costs do not occur, or occur later than forecast.

Accumulated Surplus from Passenger Security Charges - Current Status

- 3.14 As at 30 June 2009, Avsec has an accumulated surplus of \$26.169m comprising \$22.847m from the international security charges and \$4.397m from the domestic security charges, and -\$1.075m from other fees and charges (excluding the established reserves). On current projections, further surpluses will accrue on the international security charge surplus while increased costs will reduce the domestic security charge surplus through to the implementation of the proposed revised charge in April 2010. The relevant balances and projections are:

Memorandum Account Balance (\$ Millions)	International Passenger Security Charge	Domestic Passenger Security Charge	Other Fees and Charges ²	Total
Balance 30 June 2009	27.347	7.397	-1.075	33.669
Less Agreed Industry Risk Reserve	(4.500)	(3.000)		(7.500)
Net available accumulated surplus at 30 June 2009	22.847	4.397	-1.075	26.169

² The deficit under other fees and charges relates to contracted services requested by airlines and other third parties provided under contract, for which the establishment costs are recovered over the duration of the contract. Also included in this category is the cost of providing and administering the airport identity card system, vetting, and card issue.

Forecast change in surplus 1 July 2009 – 31 March 2010	3.389	-0.824	-	2.565
Forecast Balance 31 March 2010	\$26.236	\$3.573	-\$1.075	\$28.734

3.15 Surpluses have accumulated from delayed project expenditure outside Avsec's control, reduced staffing levels, cost savings, and action taken by Avsec as a result of the economic downturn. When compared with the projected costs and income for the two years of the security charge cycle through to 30 June 2009, the accumulated surplus increased \$20.438m (the passenger security charges surplus increased \$20.367m and other fees and charges \$0.071) comprising:

- delayed and reduced costs contributed of \$24.096m (\$24.230m international, \$1.013m domestic offset by \$1.147 other fees and charges);
- \$1.698m additional revenue (domestic \$4.016m, as a result of Pacific Blue entry into the market and increased competition, contracted services revenue \$1.098 offset by lower international \$3.416m);
- increased interest revenue and profit on sale of assets added a further \$2.144m; and
- offset by the establishment of the \$7.5m reserves (\$4.5m international, \$3.0m domestic).

3.16 Conversely, this surplus could have equally been a deficit had airport development accelerated and had the economic downturn not occurred.

3.17 The deferred and reduced costs which have resulted in \$24.096m one-off savings since 2007 comprised:

- Personnel and employment costs \$20.033m including:
 - staff decreases of 66 FTEs (60 operational, 6 support) coupled with prolonged vacancies during recruitment;
 - cost savings realised in the implementation of LAGs and proportional screening of airport workers, comprising recruitment and training and overtime costs;
 - the cessation of international services at Palmerston North, and domestic services at Rotorua, coupled with temporary cessation of international services at Hamilton airports all contributed savings;
 - delayed terminal expansions in Christchurch and Rotorua for international services (both now underway), resulting in delayed infrastructure and personnel costs as against forecast;
 - below budgeted staff participation in KiwiSaver;
 - retaining the 2% minimum KiwiSaver contribution rate as opposed to the forecast 4% contribution rate;
 - deferred uniform replacement;
 - reduced annual leave balances through improved management of annual leave resulted in a \$2.3m saving; and
 - reduced training costs through improved / restructured on the job training.
- In addition, operational costs reduced \$1.756m, principally as a result of reduced premises rental and operational costs (National Office premises and the Auckland operational facilities) \$1.409m, consultants and professional fees \$0.426m, delayed IT expenditure \$0.623m, insurance \$0.453m, communication

\$0.249m, offset by increased plant and equipment maintenance costs \$1.211m and \$0.193m of other minor cost savings.

- Reduced depreciation (\$1.541m) and capital charge (\$0.766m) expenditure contributed a further \$2.307m, as a result of the delayed asset replacement and purchases, comprising conventional x-ray equipment, an incident reporting system, a national rostering system, premises relocations (Auckland Operational Base and National Office) and, as a result of the economic downturn, the now non-requirement for two additional HBS x-ray machines for Auckland and one for Christchurch international Airport, and a second domestic screening lane for the former Qantas domestic departures area also at Auckland Airport.

Cost Allocation Methodology

3.18 The proposed security charges have been developed utilising cost allocation methodologies, agreed with industry in October 2005. The security services provided under the two passenger security service charges are summarised below:

International Security Charge

- International Passenger Screening
- International Foot Patrols/Searches
- International Hold Baggage Screening
- Duty Free Screening
- International Mobile Patrols
- International Aircraft Search
- International Gatehouse Duty
- International Explosive Detection Dogs
- International Escorts and VIPs
- International Transit Screening
- ID card issue

Domestic Security Charge

- Domestic Passenger Screening
- Domestic Foot Patrols/Area Searches
- Domestic Mobile Patrols
- Domestic Gatehouse Duty
- Domestic Explosive Detection Dogs
- Domestic Escorts and VIPs
- ID card Issue

4. Avsec Cost Drivers

4.1 Avsec's principal cost drivers are personnel and employment costs (which account for approximately 75% of Avsec's total cost structure). Increased operating costs due to inflation, upward rental pressures, additional infrastructural requirements (National Office accommodation and the Auckland Operational Base) and ownership costs (depreciation and capital charge) due to the ongoing requirement to invest in operational and infrastructural assets. Each cost driver is discussed below:

	2008/09 Actual	Projected Expenditure			
		2009/10	2010/11	2011/12	2012/13
Personnel & Employment Costs	50,872,609	57,251,301	59,943,798	66,045,858	69,987,999
% inc	1.5%	12.5%	4.7%	10.2%	6.0%
Operating	8,453,863	10,553,839	11,520,299	11,702,881	11,974,933
% inc	9.6%	24.8%	9.2%	1.6%	2.3%
Ownership Costs	6,775,871	8,506,490	9,527,503	9,924,743	10,077,388
% inc	4.3%	25.5%	12.0%	4.2%	1.5%
Total Expenditure	66,102,344	76,311,630	80,991,599	87,673,481	92,040,320
% inc		15.4%	6.1%	8.3%	5.0%

Personnel and Employment Costs

4.2 Personnel and employment costs account for approximately 75% (salary and wages) of Avsec's operating expense budget. The two cost drivers increasing Avsec's employment costs are the requirement for additional staff and Avsec's incremental pay structure for uniformed staff, the latter of which is determined through collective (multi-union) negotiations. Personnel and employment costs are forecast to increase by \$19.115m or 37.6% over the four year financial period 2009/13.

Additional Staff

4.3 Since the 2007 passenger security charges review, and through the onset of the current financial crisis, Avsec has allowed its national staffing levels to contract through attrition, only replacing staff where a specific need has arisen. This has enabled Avsec to operate with 66 FTE positions below establishment levels. In addition, at airports where flight cessations have occurred, Avsec has redeployed staff to other regions in an effort to retain qualified experienced staff, minimise recruitment and training costs, and preserve existing employees' employment.

4.4 Establishment levels have been reset at 773 FTEs as at September 2009 (706 operational, 67 management and support positions) This number reflects 14 operational FTE positions to be phased out through attrition over the next four years as a result of an internal efficiency review undertaken in September 2009. Representing an increase of 21 positions on the 752 FTEs at 30 June 2009. This increase is due to vacancies held pending the outcome of the efficiency review and, is well below the 840 FTE positions projected for 2009/10 financial period in the 2007 passenger security charges review.

4.5 Looking forward, Avsec has identified six new management and support positions and a potential 71 operational positions to be filled over the four-year financial period 2009/13. These staffing requirements are summarised below:

- Six management and support positions to be recruited over 2009/11 comprise one HR assistant, one assistant internal quality auditor, one EDD officer, two intelligence gathering officers, and one operations support staff;
- In September 2011 a further 29 full time Aviation Security Officers (29 FTE) will be required to return the Auckland international departures staffing to six lanes (from the current five lanes);
- In September 2011 a further 15 full time Aviation Security Officers (15 FTE) will be required to staff a third domestic screening point full time during peak periods, and to cater for additional travellers during the Rugby World Cup series; and
- In December 2012 a further 27 FTE staff will be required to staff a seventh international departures screening point (currently under construction) at Auckland International Airport, in line with projected passenger growth.

Incremental Pay Structure

4.6 The competitive environment from which potential Avsec staff is sourced creates its own costs and financial pressures, as does the incremental pay structure which Avsec operates for all uniformed staff.

4.7 Avsec's incremental pay structure applies to approximately 91% of Avsec staff. The current Collective Agreement will expire in June 2011 and will be renegotiated during this charge period. Collective contract negotiations finalised in 2008 resulted in a 5% increase in the base salary bands effective 1 July 2008 with a further 4.0% and 3.5% increase from 1 July 2009 and 1 July 2010 respectively. These increases are also reflected in overtime rates.

4.8 The nature of Avsec's incremental pay system, which comprises four to seven grade steps over a three to five year service period, adds an average compounding growth rate

of between 5.7% and 9.94% increase in salaries inclusive of the above union negotiated CPI increase, until the staff member reaches the top pay grade.

- 4.9 Pay grades are reassessed periodically to ensure they are in line with the market. This benchmarking was last undertaken in 2008 prior to the collective renegotiation. As approximately 35% of Avsec's front line staff have served less than three years (and 47% have less than five years' service), employment costs over the next three years will continue to rise faster than the rate of inflation and projected passenger growth, as the average length of service increases and staff progress up the pay scale.
- 4.10 Staff turnover for the year to 30 June 2009 approximated 6.36% and is forecast to average 9% over the period of the review. This level of staff turnover will not address this rising employment cost issue as those staff that are forecast to leave usually leave within their first two years of service and are also generally on the lower pay scales.
- 4.11 Other costs which are driving budgeted personnel costs comprise:
- Provision for increased uptake of KiwiSaver – all new employees are enrolled automatically unless they opt out. Currently 45% of Avsec staff are in KiwiSaver. Provision has been made for a further 25% of staff not already enrolled to participate in the scheme as the economy emerges out of recession;
 - The uniform update, which has been deferred from prior years, is well overdue and material stocks are approaching their optimum to undertake a progressive and controlled change, over the charges review period;
 - Staff welfare payments including fringe benefit tax and life insurance costs; and
 - Refresher screening technology training will be undertaken in 2009/10 in line with the implementation of replacement enhanced screening equipment.

Operating Expenditure

- 4.12 Operating expenditure equates to approximately 13.5% of total overheads and is forecast to increase by \$3.521m over the four-year period 2009/13. Costs are being driven by the need to provide infrastructure and capacity, principally:
- Insurance is forecast to increase \$0.561m as a result of a push by the insurance market to increase premiums, coupled with increased level of cover and the forecast changes in the US exchange rate which is used for international insurances;
 - Information technology operating costs will increase by \$0.402m, comprising computer hardware / software maintenance and licence costs for both operational and national office operations. This results from a need to invest in more automation and off the shelf software packages (e.g. a rostering system, an incident reporting system, and a national records management system);
 - Building leases and outgoings will add a further \$1.397 million, as a result of the relocation of both National Office and the Auckland operational base to new premises around November 2010. Additional costs include:
 - Increased regulatory rents with the reopening of Hamilton and Rotorua as international airports;
 - The pending opening of the Auckland International Airport expanded departure screening facility in November 2009, the planned increase of an additional domestic screening point in September 2011, and an additional international screening point in December 2012; and
 - The completion of Christchurch's international terminal and establishment of an improved HBS screening facility, while the remaining terminal screening facilities will be relocated on a like-for-like basis to new areas.

- Finance costs will increase \$0.484m as a result of the refinance of HBS equipment;
- Travel costs are set to increase \$0.383m, through increased vehicle fleet costs and the support of regional airport seasonal staffing requirements; and
- Screening equipment maintenance will increase of \$0.599m with the extension of the current HBS equipment lease for a further four-year period. Although this is a significant increase in operational costs, this is more financially cost-effective than embarking on a full replacement process and establishment a new lease at this time.

Ownership Costs and Capital Expenditure

- 4.13 Ownership costs equate to approximately 11.2% of overheads and are forecast to increase \$3.3m over the four-year period 2009/13, principally through an increase in capital charge of \$2.062m, as a result of Crown funding of infrastructure assets, and depreciation expense of \$1.238 million.
- 4.14 The \$1.238m increased depreciation charge is driven through Avsec's scheduled asset replacement program comprising motor vehicles \$0.450m, leasehold improvements \$0.257m and IT software and infrastructure assets \$0.510m.
- 4.15 Avsec's capital expenditure programme for 2009/13 is set out below. The annual phasing has been updated since the publication of Avsec's Statement of Intent for 2009/12 to reflect contractual commitments occurring post the completion of the Statement of Intent. The capital funding for this capital expenditure programme has already been provided for out to 2012/13.

Capital Expenditure Summary				
	2009/10	2010/11	2011/12	2012/13
Assets				
Furniture & Fittings	8,000	497,400		
Computer Hardware	193,700	640,100	100,300	316,100
Leased Assets	4,790,180			
Leashold Improvements	102,600	3,953,500	147,000	
Motor Vehicles	1,144,000	227,090	1,248,000	831,000
Office Equipment	33,500	187,000	29,000	
Plant & Equipment	3,537,410	2,555,525	2,802,260	2,079,810
Computer Software	1,517,900	591,000	200,000	
	11,327,290	8,651,615	4,526,560	3,226,910
Expenditure Type				
New Assets	2,349,600	5,975,390	1,241,500	10,500
Replacements	8,977,690	2,676,225	3,285,060	3,216,410
	11,327,290	8,651,615	4,526,560	3,226,910

- 4.16 The focus of Avsec's capital expenditure program remains on the replacement and selective upgrade of existing cabin baggage screening equipment and the maintenance of infrastructural assets to support Avsec's capacity and capability in delivering services.
- 4.17 Significant activities included in the capital expenditure above comprise:
- In December 2009, Avsec will renew the lease of its existing hold baggage screening (HBS) x-ray machines which are currently finance leased for a further four-year period (already negotiated). Concurrent with this renewal, the equipment will undergo refurbishment to maintain quality and reliability of service. December 2013 will see the full replacement of this equipment as it reaches the end of its economic life;

- The relocation of Avsec National Office premises (currently subject to a six month demolition clause) to new premises and the development of new on-airport premises for the Auckland Operational Base (currently operating out of undersized premises and two portacoms on Auckland International Airport leased land) will incur \$3.953m of leasehold costs. Both these premises will result in long-term permanent accommodation for each division;
- Plant and equipment replacement comprises the programmed replacement of screening equipment and the purchase of additional equipment to support new screening points at Auckland international and domestic departures;
- Motor vehicle replacement comprises the programmed replacement of existing fleet vehicles and the purchase of an additional Explosive Detection Dog (EDD) unit vehicle in 2009/10; and
- Computer software comprises investment in a workforce management roster system, records management system, an incident reporting system, additional HBS tutor x-ray software licences for recurrent testing of staff, a finance system purchase order module and development/rewrite of the Avsec statistical database.

5. Proposed new passenger security charges

Summary

- 5.1 Treasury guidelines recommend that any accumulated surplus or deficit (memorandum account balance of available reserves) should be taken into consideration when setting subsequent charges, and that the charges should be set to reflect the (whole of life) cost of providing the service.
- 5.2 In applying this methodology, Avsec has given consideration to the relative size of the surpluses and the resulting impact these would have on the respective passenger security charges over both the short and medium term - the emphasis being on maintaining stability in the charges over the medium term while ensuring that the charges reflect the true cost of providing the service.
- 5.3 As a consequence, Avsec considers it inappropriate to fully offset the international passenger security charge accumulated surplus solely over the next charge period, as to do so would unduly promote a cross-subsidisation between the passenger charges and exacerbate any future required increases. Likewise Avsec acknowledges it is inappropriate to retain the surplus for no valid reason.
- 5.4 By taking a medium-term view on the utilisation of the surplus, stability can be brought to the charges at a level that approximates the true whole-of-life cost of providing the service while simultaneously providing a buffer against any adverse cost or revenue event, such as an adverse variation in passenger projections, new operators entering the market and requiring services, or the start-up and restart of airports.
- 5.5 This approach is considered prudent given the high proportion of Avsec's cost structure coming from staff (who require a lead-in time to recruit and train) and the asset intensive nature of Avsec's operations. This means that these costs cannot be quickly turned on or off without incurring significant exit or start-up costs.
- 5.6 Avsec has identified a number of options for industry consideration that utilise part or the entire accumulated surplus.
- 5.7 In determining these options, Avsec has taken into account known and planned costs, the impact on operational costs of new technology, capital requirements, and the overall change in Avsec's cost structure brought about through airport development, delayed developments, projected passenger growth, new entrant airlines, start-ups and restarts of airports and the impact of inflation.

Baseline International Passenger Security Charge

- 5.8 The baseline international passenger security charge has been determined at \$13.80 GST Inc and includes a \$0.11 GST Inc Airport Identity Card cost contribution. The charge is based on a four-year average of Avsec's total forecast costs for the 2009/13 financial period divided by the projected passenger numbers for that period.
- 5.9 This baseline charge is \$1.20 lower than the current international passenger security charge and does not take into account the utilisation of any accumulated surpluses or any of the unfunded financial risks outlined in paragraph 3.12.

Baseline Domestic Passenger Security Charge

- 5.10 The baseline domestic passenger security charge has been determined at \$4.88 GST Inc and includes a \$0.05 GST Inc Airport Identity Card cost contribution. The charge is also based on a four-year average of Avsec's total forecast costs for the 2009/13 financial period divided by the projected passenger numbers for that period.
- 5.11 This baseline charge is \$0.22 higher than the current domestic passenger security charge and does not take into account the utilisation of any accumulated surpluses or any of the unfunded financial risks outlined in paragraph 3.12.
- 5.12 Both of the above charges are the minimum that should be charged in order for Avsec to fully recover its projected operating costs over the four-year period 2009/13 and are provided as a reference point from which the proposed charges should be measured.

Treatment of Accumulated surplus – Options for Consultation

Options – Overall summary

- 5.13 The following options for the treatment of the accumulated surpluses of both the International and Domestic Passenger Security Charges are put forward for consultation.

International Passenger Security Charge	
Option one	a) Utilise the available surplus over a three year period 2010/13; OR (b) Utilise the available surplus over six years (two charging periods).
Option two	Retain part of the accumulated surplus for specific security risks/initiatives; AND (a) Utilise the remaining available surplus over a three year period 2010/13; OR (b) Utilise the remaining available surplus over six years (two charging periods).
Option three	Retain part of the surplus to aid the replacement of HBS in 2013; AND (a) Utilise the remaining available surplus over a three year period 2010/13; OR (b) Utilise the remaining available surplus over six years (two charging periods).
Domestic Passenger Security Charge	
Option One:	Utilise all of the available accumulated surplus over a three year period.
Option Two:	Retain part of the charge for airport start-up and utilise the remainder of the available surplus over a three-year period.

5.14 Each option is discussed in more detail in the following sections.

International Passenger Security Charge – Accumulated Surplus Treatment Options

Option 1: Utilise the total accumulated surplus over a three-year (2010/13) or six-year (2010/16) period.

Option 1(a): Utilise the total available surplus over a three year period (2010/13). Under this option it is proposed that the surplus would be absorbed on a pro-rata basis within the new charge at the rate of \$2.26 GST Inc (\$2.01 GST Exc) (calculated as the surplus divided by the projected passenger numbers for the three-year financial period April 2010 – March 2013).

5.15 The new charge would be \$11.54 GST Inc (\$10.25 GST Exc) and would utilise 100% \$26.236m of the surplus over the current charge period.

5.16 Once 13.050m passengers had been charged the Passenger Security Charge would then need to increase by a minimum of the rebate (\$2.26 GST inclusive) to reflect the full utilisation of the surplus. It is expected that this charge re-set would coincide with the three-year annual review of the charge.

5.17 Advantages / Disadvantages of this option

Advantages:

- Utilises 100% of the available surplus over the three year charge period.

Disadvantages:

- This option masks the true cost of the underlying service provided;
- Provides a subsidy to a group of passengers without reference to the services they receive or the generation of the surplus;
- Provides no attempt to smooth the charge to reflect the whole of life costs of providing the service;
- Will result in the largest charge increase at the end of the three year charge period of all the options, to return the charge to its base level;
- Requires the charge to be reset as soon as 13.050m passengers have been charged in order to avoid creating a deficit; and
- Provides minimal relief or reserves against any adverse event or variation in forecast passenger numbers during the charge period.

OR

Option 1(b): *Utilise the remaining accumulated surplus over six years, 50% in the first charge period April 2010–March 2013, and the remaining 50% over the following three-year charge period. It is proposed that the surplus to be utilised would be absorbed on a pro rata basis within the new charge at the rate of \$1.13 GST Inc (\$1.01.GST Exc) for the first three-year period (calculated as the available surplus over the projected passenger numbers for the three-year period April 2010–March 2013).*

5.18 The new charge would become \$12.67 GST Inc (\$11.26 GST Exc) and would utilise 50% or \$13.118m of the surplus over the current charge period.

5.19 Once 13.050m passengers had been charged, the charge would then need to increase by a minimum of the rebate (\$1.13 GST inclusive) to reflect the 50% utilisation of the surplus. It is expected that this charge re-set would coincide with the three-year annual review of the charge and that the remaining 50% surplus, \$13.118m would be taken into account when re-setting the charge at that time.

5.20 Advantages/Disadvantages of this option

Advantages:

- Utilises 50% of the available surplus over the new charge period if the forecast number of passengers is accurate;
- Defers 50% of the available surplus to a future charge period, enabling some relief or reserves against any adverse event or variation in forecast passenger numbers during the initial charge period;
- Allows flexibility around when the next charge is required to be set, by minimising the possibility of Avsec running into a deficit; and
- Allows for the option to smooth future increases to reflect whole of life costs of providing the service.

Disadvantages:

- This option masks the true cost of the underlying service provided due to the rebate; and
- Provides a subsidy to a group of passengers without reference to the services they receive or the generation of the surplus.

Option 2: Retain part of the charge for specific security risks/initiatives and utilise the remainder of the accumulated surplus over a three-year (2010/13) or six-year (2010/16) period:

5.21 Under this option it is proposed that \$10.576m of the accumulated surplus be retained to fund three specific security risks/initiatives outlined below, with the remainder utilised within the setting of the charge, over either a three or six-year period.

Initiative 1: Research and development - \$1.0m

5.22 Avsec has an obligation under the Civil Aviation Act section 80, to keep “*itself informed of developments in security techniques, systems, devices, practices, and procedures related to the protection of civil aviation and persons employed in or using it*” including to “*undertake, or encourage or supervise, such experimental or research work in respect of aviation security as the director may specify*”.

5.23 The Domestic Aviation Security Review also indicated that all airports were strongly encouraged to consider and incorporate possible future screening requirements when planning terminal expansion or changes.

5.24 Aligned with this emphasis and the recent internal efficiency review, Avsec is seeking to establish a \$1.0m fund to research, evaluate and undertake controlled trials of alternative screening point design and approved equipment. As part of this, Avsec is looking to acquire a computerised modelling program to aid in scenario modelling of screening point design to ensure optimum efficiency given a definable set of constraints, with additional funds to implement controlled evaluation and field trials of new screening point designs. The overall objective remains to ensure security is not compromised (including congestion points not being exploited), screening throughput is maximised, on-time performance is maintained, staff are effectively and efficiently utilised and the experience for the passenger is improved and properly managed.

Initiative 2: Technology Advances - Implementation of LAGs/Explosive Detection - \$3.850m

5.25 One of the biggest negative issues facing airlines, airports, Avsec and the travelling public is the screening for Liquids Aerosols and Gels (LAGs). Since April 2006 Avsec has had to search, find and remove approximately 212.5 tonnes of LAGs in Auckland alone (excluding what the airlines remove), valued in the millions of dollars. Avsec continues to collect in excess of two tonnes per week at Auckland International Airport, for which airlines incur approximately \$0.246m in annual disposal costs.

- 5.26 Significant advances in the screening for liquid explosives in cabin baggage have occurred, but, as yet, the available equipment is either too slow, or has unacceptable false alarm rates. Hence no equipment has yet been certified/approved for use by the United State's Transportation Security Administration (TSA) or United Kingdom Department for Transport (UK DfT).
- 5.27 The European Commission has announced a target date of April 2010 for a rule change on the Screening of LAGs, while both Smiths with its aTix, and Rapiscan with its 620DV Advanced Cabin Baggage X-ray (ACBX) machines are working towards a technology/software solution by April 2011.
- 5.28 One supplier's machine (the aTix) is already in operation at both Glasgow and Heathrow airports. Both the TSA and the Canada authorities have pre-empted this technology breakthrough by replacing their existing equipment with these Advanced Cabin Baggage x-ray machines which are capable of being retrofitted with the new technology.
- 5.29 When the technology becomes available, New Zealand will have to move quickly in adopting this technology or risk being out-of-step with the rest of the world and continuing to frustrate passengers. (The Rugby World Cup in late 2011 falls within this time frame).
- 5.30 Avsec is proposing to retain \$3.850m of the international passenger security charge accumulated surplus to cover the first three of the six year depreciation and finance cost of eighteen ACBX units or equivalent equipment required for international screening, with a view to purchasing (subject to tender) and implement such equipment as soon as it's available and certified/approved by the TSA and UK DfT for use.

Initiative 3: Start-Up and Restarts of Airports - \$5.726m

- 5.31 With the competitive environment in both the domestic and international air travel markets and the emergence of low cost airlines, Avsec is in the difficult position of having to respond at short notice to substantive changes in the demand for screening services.
- 5.32 Over the past eighteen months Avsec has seen the withdrawal of scheduled flights from Palmerston North, Hamilton, and Rotorua, and cutbacks in other centres. Within four months of Hamilton's closure, Avsec has seen new entrants filling the market gaps to establish/re-establish new services (Hamilton 1 September 2009 and Rotorua 12 December 2009). Such activity is likely to continue.
- 5.33 Under current legislation Avsec is required to meet and have the capacity and capability to deliver the necessary aviation security service as and when required. To date, Avsec has been able to meet this challenge as the majority of change has occurred within existing airport infrastructure.
- 5.34 However, with the scale-back of services in line with demand, the confidentiality around planned airline services and schedules, Avsec has limited financial reserves to respond to airport start-ups or restarts. Accordingly, Avsec is proposing to retain \$5.726m to manage the start-up of two additional international regional airports, one at the beginning of the charge period and a second halfway through the charge period.
- 5.35 With reference to the accumulative surplus utilisation, the following options are provided:
Option 2(a): *Retain \$10.576m and utilise the remaining accumulated surplus over a three-year period.* It is proposed that the remainder of the accumulated surplus would be absorbed on a pro rata basis within the new charge at the rate of \$1.35 GST Inc (\$1.20 GST Exc) (calculated as the available surplus divided by the projected passenger numbers for the three year financial period April 2010–March 2013).
- 5.36 The new charge would become \$12.45.GST Inc (\$11.06 GST Exc) and would utilise 59.69% or \$15.660m of the surplus over the current charge period.
- 5.37 As with Option One, once 13.050m passengers have been charged the passenger security charge, the charge would then need to be increased by a minimum of the rebate

(\$1.35 GST Inc) to reflect the full utilisation of the surplus in order to avoid the generation a deficit. It is expected that this charge re-set would coincide with the three-year review of the charge and that any remaining surplus or unutilised costs from the above initiatives would be reviewed and taken into account when re-setting the charge at that time

5.38 Advantages / Disadvantages of this option

Advantages:

- The passenger security charge more closely approximates the cost of the service and is held more stable in dollar terms, due to the rebate being of a lesser value;
- Operational funding is immediately available for significant Research and Development, and for a LAGs solution as soon as it becomes available without the need for a capital bid or appropriation as the operational funding assumes the equipment will be finance leased;
- Operational funding is immediately available to cater for any start-up or restart of an international airport, thereby supporting tourism and allowing airlines to establish niche market and explore other more non-traditional routes;
- The surplus is more appropriately applied for the purpose for which the underlying charge was intended and collected as opposed to subsidising other users of the services; and
- If any of the risks/initiatives costs are under-utilised the rebate could be left to continue to run out the remaining accumulated surplus over time or utilised to offset future costs, or the passenger security charge reset.

Disadvantages:

- A LAGs solution may not eventuate during the current charge period, resulting in the associated retention not being utilised in the timeframe intended; and
- If the start-up and restart costs do not eventuate, the surplus will remain. (However the rebate could be left to continue to run out the surplus or the passenger security charge reset).

OR

Option 2(b): *Retain \$10.576m and utilise the remaining accumulated surplus over six-years, 50% in the first charge period April 2010–March 2013, and the remaining 50% over the following three-year charge period.* It is proposed that the surplus to be utilised would be absorbed on a pro rata basis within the new charge at the rate of \$0.67 GST Inc (\$0.60.GST Exc) for the first three-year period (calculated as the available surplus over the projected passenger numbers for the three-year period April 2010–March 2013).

5.39 The charge would become \$13.12.GST Inc (\$11.66 GST Exc) and would utilise 29.84% or \$7.830m of the surplus over the current charge period.

5.40 As with the above options, once 13.050m passengers had been charged the passenger security charge, the charge would then need to be increased by a minimum of the rebate (\$0.67 GST Inc) to reflect the \$7.830m utilisation of the surplus and avoid generation of a deficit. It is expected that the charge re-set will coincide with the three-year annual review of the charge and that the remaining surplus, \$7.830m along with any unutilised costs from the above initiatives would be reviewed and taken into account when re-setting the charge at that time.

5.41 Advantages / Disadvantages of this option:

Advantages:

- Same as for Option 2(a);
- Option 2(b) provides additional relief over option 2(a) for the initial period of the charge by retaining part of the available surplus (50%) to be utilised to defray future increases in the passenger security charge; and
- If any of the initiatives are not utilised the rebate could be left to continue to run out the surplus over a longer period.

Disadvantages:

- Same as for Option 2(a).

Option 3: Retain part of the surplus to aid the replacement of Hold Baggage Screening (HBS) in 2013

5.42 Under this option it is proposed that \$8.887m of the surplus be retained to smooth the increased operational cost associated with the replacement of HBS equipment in 2013 as outlined below, with the remainder utilised within the setting of the charge over a period of three or six years.

Replacement of HBS equipment in 2013

5.43 Avsec's lease of its existing HBS expires in December 2009. Agreement has been reached to release and refurbish this equipment for an extended four-year period through to December 2013. During 2013, Avsec will have no option but to replace this eight year old equipment. This replacement exercise will involve considerable planning to ensure minimal impact on service delivery and airport and airline operations and will be undertaken throughout July–December 2013.

5.44 Replacement equipment is currently estimated at a cost of \$22.0m. It is assumed the equipment will be finance leased at a projected finance interest rate of 9.95%. This equates to an eight year average (interest and depreciation cost) of \$3.922m per annum based on an eight-year asset economic life, or \$0.81 cents per passenger on projected volumes. The first three years' cost (interest and depreciation) amount to an additional \$8.887m over the costs of the current charges review period.

5.45 Under this option Avsec is proposing to recover the first three of the eight year incremental operational costs associated with this equipment replacement (amounting to \$8.887m) from the international passenger security charge accumulated surplus.

5.46 With reference to the remaining accumulated surplus utilisation, the following options are provided:

Option 3(a): *Retain \$8.887m and utilise the remaining accumulated surplus over a three-year period.* It is proposed that the accumulated surplus would be absorbed on a pro rata basis within the new charge at the rate of \$1.50 GST Inc (\$1.33.GST Exc)(calculated as the available surplus over the projected passenger numbers for the three-year period April 2010 to March 2013).

5.47 The charge would become \$12.30.GST Inc (\$10.93 GST Exc) and would utilise 66.13% or \$17.349m of the surplus over the current charge period.

5.48 As with the above options, once 13.050m passengers had been charged the passenger security charge, the charge would then need to be increased by a minimum of the rebate (\$1.50 GST Inc) to reflect the full utilisation of the surplus and avoid generation of a deficit. It is expected that the charge re-set will coincide with the three-year annual review of the charge.

5.49 Advantages / Disadvantages of this option:

Advantages:

- The passenger security charge closely approximates the cost of the underlying service due to minimal subsidisation between charging cycles;
- Operational funding is provided to cover the three-year increased cost associated with the replacement of HBS equipment;
- The level of the passenger security charge is held more stable in dollar terms over the medium term, as the increase in costs associated with replacement HBS equipment is averaged over a number of charge cycles; and
- The surplus is more appropriately applied to the purpose for which the underlying charge was intended and collected as opposed to subsidising other users of the services.

Disadvantages:

- Only 66.13% of the available surplus will be utilised over the current charge period.

OR

Option 3(b) *Retain \$8.887m and utilise the remaining accumulated surplus over a six-year period, 50% in the first charge period (April 2010–March 2013) and the remaining 50% over the following three-year charge period. It is proposed that the surplus to be utilised would be absorbed on a pro rata basis within the new charge at the rate of \$0.75.GST Inc (\$0.66 GST Exc) (calculated as the available surplus over the projected passenger numbers for the three-year period April 2010-March 2013).*

5.50 The charge would become \$13.05.GST Inc (\$11.60 GST Exc) and would utilise 33.06% or \$8.674m of the surplus over the current charge period.

5.51 The remaining 50% surplus (\$8.674m) to be utilised over subsequent charge period would be retained to act as a contingency, and be available to fund operational costs associated with international start-ups and restarts, specifically approved research and development projects, and the implementation of LAGs detection equipment if these occur within the charge period.

5.52 As with the above options, once 13.050m passengers had been charged the passenger security charge, the charge would then need to be increased by a minimum of the rebate (\$0.75 GST Inc) to reflect the utilisation of the \$8.674m surplus and avoid generation of a deficit. It is expected that the charge re-set will coincide with the three-year annual review of the charge and that the remaining surplus of \$8.6740m would be taken into account when re-setting the charge at that time.

5.53 Advantages/Disadvantages of this option:

Advantages:

- The passenger security charge closely approximates the cost of the underlying service due to minimal subsidisation between charging cycles;
- The \$8.674m surplus provides a contingency available to be immediately applied to fund operational costs associated with international start-ups and restarts, specifically approved research and development projects, and the implementation of equipment for LAGs or adverse economic events occurring during the charge cycle as may be required;
- The passenger security charge is held more stable over the medium term as the increase costs associated with replacement HBS equipment in 2013 is covered over a number of charge cycles; and

- The surplus is more appropriately applied to the purpose for which the underlying charge was intended and collected as opposed to subsidising other users of the services.

Disadvantages:

- Only 33.6% of the available surplus will be utilised over the current charge period.

Avsec's preferred option (international)

- 5.54 Option 3(b) is Avsec's preferred option, as it provides greatest comfort to both airlines and the travelling public as to the stability of the international passenger security charge over the next three to six year period. It affords Avsec the ability to manage its known and unknown operational risks and absorb/cushion any unforeseen financial impact during a period of unknown economic stability. It also supports tourism and the growth of the economy by affording Avsec the financial resources to respond to any mandated demand (international start-up or restart) or substantial change in demand for services.
- 5.55 This option also goes some way to minimising cross-subsidisation from one group of passengers to another, by maintaining the passenger charge at its approximate cost, and apportioning the surplus over a more equitable medium term basis.

Proposed Revised Charges:

	Charge	Airport Identity Cards	Surplus Reserves Utilisation	Proposed Charge	Current Charge	Change
International Passenger Security Charge	\$13.68 (\$12.16 GST excl)	\$0.11 (\$0.10 GST excl)	\$0.66 (\$0.75 GST excl)	\$13.05 (\$11.60 GST excl)	\$15.00 (\$13.33 GST excl)	\$1.95 (\$1.73 GST excl)

Domestic Passenger Security Charge Surplus Options:

Option 1: Utilise the total surplus over a three year period

- 5.56 Under this option it is proposed that the surplus would be absorbed on a pro rata basis within the new charge at the rate of \$0.22 GST Inc (\$0.20 GST Exc) per passenger (calculated as the surplus over the projected passenger numbers for the three-year period April 2010–March 2013).
- 5.57 The charge would become \$4.66 GST Inc (\$4.14 GST Exc) and would utilise 100% \$3.572m of the surplus over the current charge period.
- 5.58 This would mean that once 17.445m passengers had been charged, the domestic passenger security charge would need to increase by a minimum of \$0.22 GST Inc to reflect the full utilisation of the surplus plus any underlying increase in Avsec's costs at the time of the review. It is expected that the charge re-set would coincide with the three-year annual review of the charge.
- 5.59 In support of this proposal, Avsec considers that it is unlikely that a domestic jet service will expand into any non-security designated regional airports compared with the probability of a start-up of an international low cost carrier or the expansion of an international airport into a domestic jet service operation. In the latter case, the infrastructure and staffing at security designated airports (with the exception of a major redevelopment) would result in only a moderate incremental cost increase for Avsec. However, if one should start up and Option Two (below) is not accepted, then Avsec would seek an increase in the domestic passenger security charge or require some other source of funding.

Option 2: Retain \$2.760m for airport start-up and utilise the remaining accumulated surplus over the three-year period of the charge

- 5.60 Cost and passenger projections underlying the proposed domestic passenger security charge support a charge of \$4.88 GST Inc (\$4.34 GST Exc) versus the current charge of \$4.66 GST Inc (\$4.14 GST Exc). This represents an increase of \$0.22 GST Inc cents per passenger.
- 5.61 Under this proposal, \$2.760m of the surplus would be retained to support the start-up and three years operating costs of a new domestic jet service at either an existing security designated airport or a new regional airport facility.
- 5.62 The remaining \$0.812m surplus would be absorbed on a pro rata basis within the new charge at the rate of \$0.05 GST Inc (\$0.05 GST Exc) per passenger (calculated as the surplus over the projected passenger numbers for the three-year period April 2010 - March 2013). This would result in the charge having to be increased now by \$0.17 GST Inc to \$4.83 GST Inc (\$4.29 GST Exc) and would utilise 22.75% or \$0.812m of the surplus over the current charge period.

Avsec's preferred option (domestic)

- 5.63 Option 1 is Avsec's preferred option, as the runout of the existing surplus is currently forecast to coincide with the review and resetting of the charge in March 2013.

	Charge	Airport Identity Cards	Surplus Reserves Utilisation	Proposed Charge	Current Charge	Change
Domestic Passenger Security Charge	\$4.83 (\$4.29 GST excl)	\$0.05 (\$0.04 GST excl)	-\$0.22 (-\$0.20 GST excl)	\$4.66 (\$4.14 GST excl)	\$4.66 (\$4.14 GST excl)	No change

6. International and Domestic Passenger Projections

- 6.1 Avsec receives the domestic passenger security charge from all commercial domestic carriers operating aircraft in excess of 90 seats, on a per passenger/sector charge basis. The international passenger charge is received from airlines based on passenger departures on international flights. Exemptions apply to infants under two years of age, crew, repositioning crew or transiting international passengers, all of which are however still subject to screening measures.
- 6.2 Based on an analysis of the current passenger numbers and trends, and having taken into account the views of industry, and relevant travel statistics, Avsec has applied the following international and domestic passenger numbers in its financial projections and modelling.

Airport	2008/09 Actual		2009/10		2010/11		2011/12		2012/13		2008-2012			CAGR		Overall
		% Var		% Var		% Var		% Var		% Var	Overall	AVG	CAGR	2003 - 2008	2003 - 2013	
International																
Auckland	3,153,343	-2.20%	2,986,544	-5.29%	3,016,410	1.00%	3,135,558	3.95%	3,213,947	2.50%	1.92%	0.48%	0.48%	5.76%	2.80%	
Hamilton	23,782	-42.95%	41,093	72.79%	47,816	16.36%	49,704	3.95%	50,947	2.50%	114.23%	28.56%	20.98%	-5.41%	-0.77%	
Rotorua			8,432	0.00%	14,291	69.49%	14,856	3.95%	15,227	2.50%						
Palmerston North	-	0.00%	-	0.00%	-	0.00%	-	0.00%	-							
Wellington	312,920	6.57%	302,222	-3.42%	305,244	1.00%	317,301	3.95%	325,234	2.50%	3.94%	0.98%	0.97%	6.47%	4.25%	
Christchurch	757,987	-4.13%	757,489	-0.07%	765,064	1.00%	795,284	3.95%	815,166	2.50%	7.54%	1.89%	1.83%	10.22%	5.30%	
Dunedin	25,705	-26.18%	30,275	17.78%	30,578	1.00%	31,785	3.95%	32,580	2.50%	26.75%	6.69%	6.10%	-2.28%	-1.80%	
Queenstown	38,671	30.24%	47,642	23.20%	48,118	1.00%	50,019	3.95%	51,269	2.50%	32.58%	8.14%	7.30%	33.59%	22.07%	
	4,312,408	-2.78%	4,173,697	-3.22%	4,227,521	1.29%	4,394,507	3.95%	4,504,370	2.50%	4.45%	1.11%	1.09%	6.24%	3.23%	
Domestic																
Auckland	2,108,148	0.11%	2,090,682	-0.83%	2,155,494	3.10%	2,260,035	4.85%	2,321,960	2.74%	10.14%	2.54%	2.44%	6.33%	4.13%	
Hamilton																
Rotorua	25,963	-44.65%														
Wellington	1,551,183	-1.25%	1,490,485	-3.91%	1,536,690	3.10%	1,611,219	4.85%	1,655,367	2.74%	6.72%	1.68%	1.64%	7.69%	4.32%	
Christchurch	1,486,813	-0.88%	1,450,812	-2.42%	1,495,787	3.10%	1,568,332	4.85%	1,611,305	2.74%	8.37%	2.09%	2.03%	5.72%	3.56%	
Dunedin	204,230	24.13%	199,684	-2.23%	205,874	3.10%	215,859	4.85%	221,773	2.74%	8.59%	2.15%	2.08%	10.90%	8.50%	
Queenstown	244,314	-8.30%	226,194	-7.42%	233,206	3.10%	244,517	4.85%	251,217	2.74%	2.83%	0.71%	0.70%	12.88%	5.62%	
	5,620,651	-0.60%	5,457,857	-2.90%	5,627,051	3.10%	5,899,962	4.85%	6,061,622	2.74%	7.85%	1.96%	1.91%	7.10%	4.21%	

- 6.3 Avsec believes these passenger projections are appropriate for the current economic climate and for the purpose of calculating the charges. The projected passenger movements are based on outbound passenger numbers for which Avsec collects a passenger security charge. This is different from the total passenger movement at a particular airport.
- 6.4 During the last passenger security charges review in 2007, passenger projections were agreed with industry. However, those growth projections have not been realised and this is one of the reasons why this current review is being undertaken.
- 6.5 The passenger numbers applied in the 2007 security charge review compared with actual are as follows:

Airport	2006/07 Forecast		2007/08		2008/09		2009/10		Review 3 year 2007-08 2009- 2010 CAGR
		% Inc		% Inc		% Inc		% Inc	
International									
Charges Review 2007	4,281,855	0.65%	4,457,342	4.10%	4,580,023	2.75%	4,705,892	2.75%	3.20%
Actual	4,359,184	2.47%	4,435,664	1.75%	4,312,408	-2.78%			
Domestic									
Charges Review 2007	4,953,994	0.93%	5,102,454	3.00%	5,197,305	1.86%	5,294,293	1.87%	2.24%
Actual	5,024,706	2.37%	5,654,619	12.54%	5,620,651	-0.60%			

7. Airport Identity Cards

- 7.1 The cost of maintaining and issuing permanent Airport Identity Cards (AICs) has been and continues to be charged on a cost recovery basis and is recorded under other fees

and charges. The costs associated with the issue of *temporary* AICs however is funded through both the international and domestic passenger security charges as these costs are too small to be efficiently charged to the applicant on a cost recovery basis. These costs have increased in line with the issue of temporary AICs, Avsec personnel cost structure and the cost of maintaining the AIC database. During the last financial year 7,314 permanent and 53,543 temporary AICs were issued.

- 7.2 Avsec proposes to increase the 'charges' component of each temporary AIC from \$0.06 to \$0.11 GST Inc per international passenger and from \$0.01 to \$0.05 GST Inc per domestic passenger to recover this increased cost associated with administering these cards and running its AIC database.

8. Pre-Paid Airline tickets

- 8.1 The airline industry has argued in the past that it is unable to impose and therefore recoup the cost of any passenger security charge increase for tickets sold prior to the Gazetting of the new passenger security charges for travel undertaken after the implementation date of the new charges.
- 8.2 At the last review where the charges were increased, a period of grace was extended to airlines to return the previous charge where a ticket was sold prior to the Gazetting date for travel up to six months after the implementation date of the new charges.
- 8.3 For the 2007 charges review this dispensation applied to 399,165 domestic and 547,581 international pre-paid passenger tickets.
- 8.4 It is Avsec's view, that the pre-paid ticket dispensation should be applied irrespective of an increase or decrease in the passenger security charges. As with the setting of previous charges Avsec would like to consult with industry on an appropriate timeframe for this dispensation.
- 8.5 An option for consultation is that, for the purpose of this charges review, the dispensation should not apply, and that the charge becomes effective from the date the new charges are Gazetted. This treatment is administratively easier for all parties but would afford a saving to International airlines carriers of approximately \$0.947m (and no change for domestic airline carriers) in over collected passenger security charges based on historic prepaid passenger claims and Avsec's preferred options outlined above.
- 8.6 The passenger security charges outlined in sections 5 and 6 of this consultation document have been based on the assumption that the new international charge would become effective from the date of Gazetting and that there would be no dispensation to airlines as previously provided. Should this prove not to be the case then the international passenger security charge accumulated surplus would accordingly increase by the value of the over collected passenger security charge

9. Consultation Process and Recommendations

- 9.1 Avsec has presented its analysis of the likely operational impacts of ongoing development and changes in the aviation sector and the costs of such developments. Industry comment and input is now sought to assist Government to re-set the passenger security charges. Written responses from industry to this consultation document are sought by 5pm Monday 30 November 2009. In addition to formal consultation meetings, senior Avsec staff are also available to discuss or clarify this consultation document during the consultation period.

Written responses from industry to this consultation document are to be sent to:

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9.2 Following the consultation period, a proposal will be put before the Cabinet on any proposed changes to the charges, regulations will be set and any new charges are expected to be in place in April 2010.

It is recommended:

That BARNZ, industry and Government departments:

- Consider this consultation document, and the basis on which Avsec has produced its financial projections;
- Acknowledge Avsec's forecasts and projected passenger numbers, accept the charges as developed, and note the options provided for utilising the cumulative surpluses; and
- Provide a written opinion on the preferred options for utilising the cumulative surpluses and the reasons for this.