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**Improving the Competitiveness of Michigan for Air
Service**

Testimony Before the State Senate Finance Committee

May 14, 2014

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The Michigan Economy — and Its Workforce — Benefit From a Healthy Airline Industry

- More than \$10 billion in Michigan GDP and 168,000 jobs, including 16,000 airline workers and retirees (19th among states in aviation impact on economy)
- 665 scheduled airline departures per day from 16 airports to 147 destinations spanning 17 countries, transporting 18 million passengers and 144,000 tons of cargo transported annually
- Detroit enjoys 539 scheduled flights per day, while Grand Rapids (49), Flint (16), Lansing (13), Traverse City (12), Kalamazoo (11) have more than 10 per day, followed by Saginaw, Marquette, Pellston, Hancock, Muskegon, Iron Mountain, Alpena, Escanaba, Sault Ste. Marie and Manistee
- In 2012 U.S. passenger airlines remitted \$217 million to Detroit (DTW):
 - \$89.0 million in terminal rents
 - \$64.6 million in landing fees
 - \$62.1 million in passenger facility charges
 - \$1.4 million in federally imposed aviation taxes



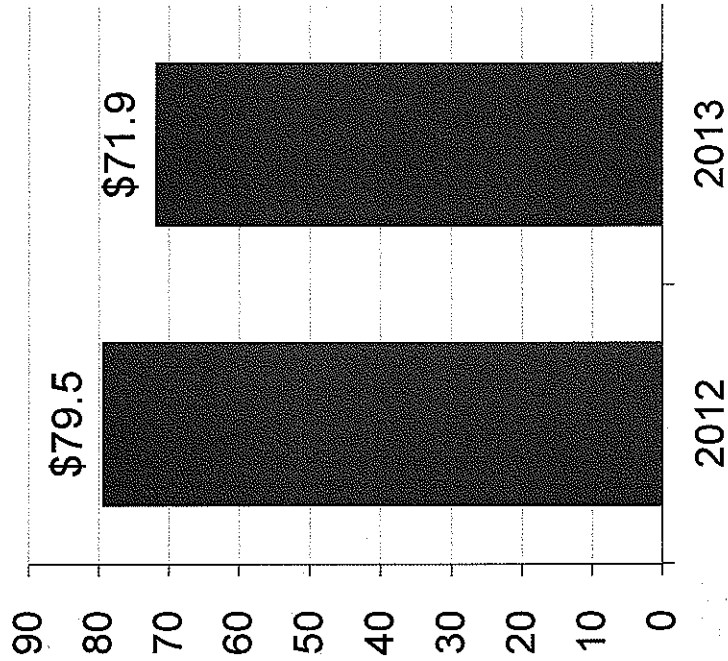
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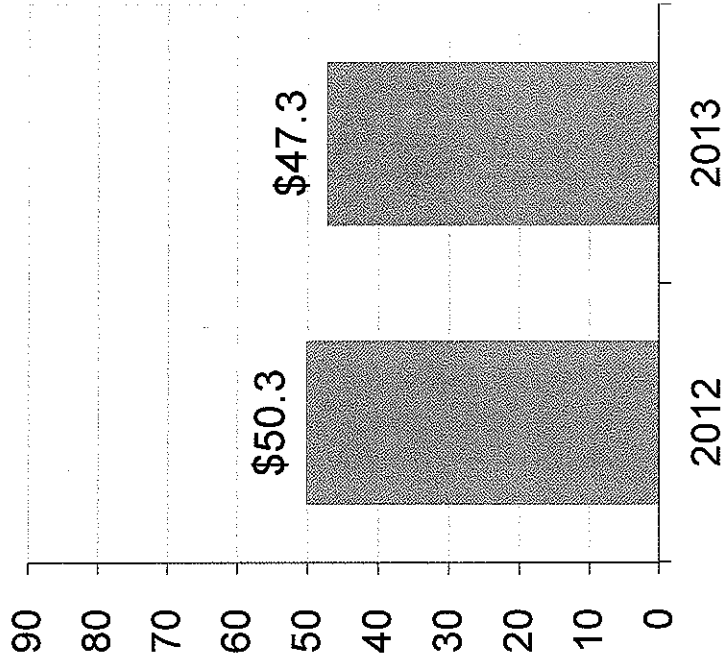
Years of Staggering Losses Have Left U.S. Airlines* Saddled With Debt

"...it would be unreasonable to assume that all airline risks have just disappeared... [T]he business model requires a large cushion of cash and significant reinvestment." (Alexander MacLennan, The Motley Fool, "How 'Shareholder Friendly' Should Airlines Be?" Feb. 3, 2014)

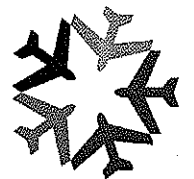
Total Debt (\$ Bills, Dec. 31)



Net Debt (\$ Bills, Dec. 31)



* SEC filings of Alaska, Allegiant, American/US Airways, Delta, Hawaiian, JetBlue, Southwest, Spirit and United



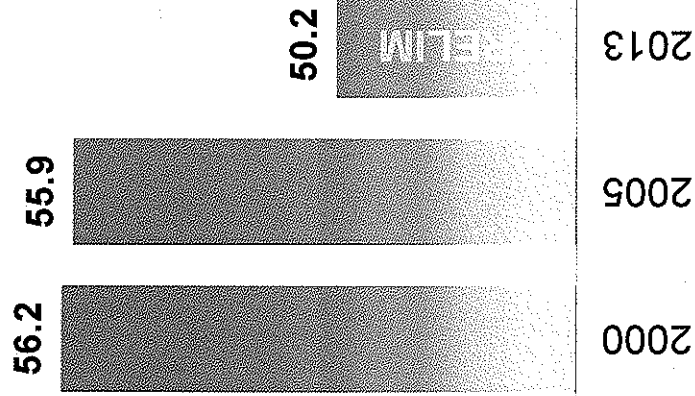
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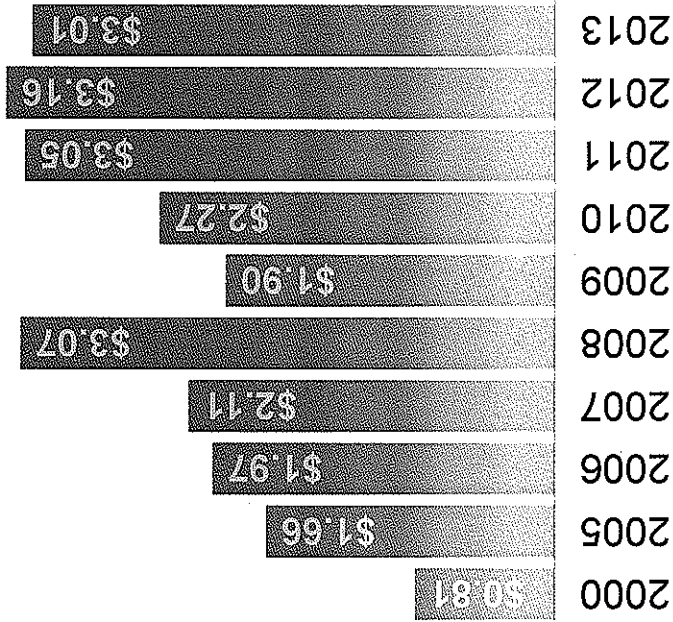
In 2013, U.S. Airlines' Fuel Bill Exceeded \$50 Billion for Third Consecutive Year

Average Price Paid for Jet Fuel Rose 272% in 2000-2013, Including 32% in 2010-2013

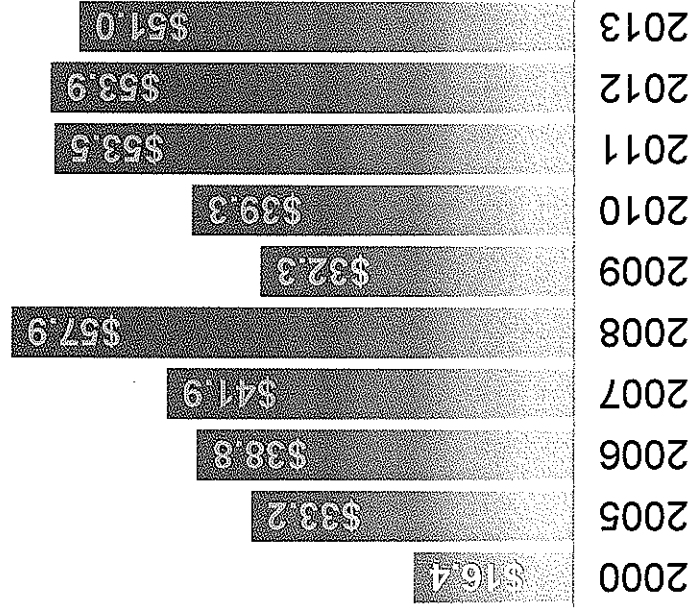
Using Less Fuel But ...
Million Gallons per Day



Due to Rising Prices ...
USD per Gallon (Avg. Price Paid)



... Incurring Higher Costs
Billion USD per Year



Source: BTS (T2: 921) for U.S. airlines

Source: BTS (Form 41 P-12(a) for U.S. airlines)

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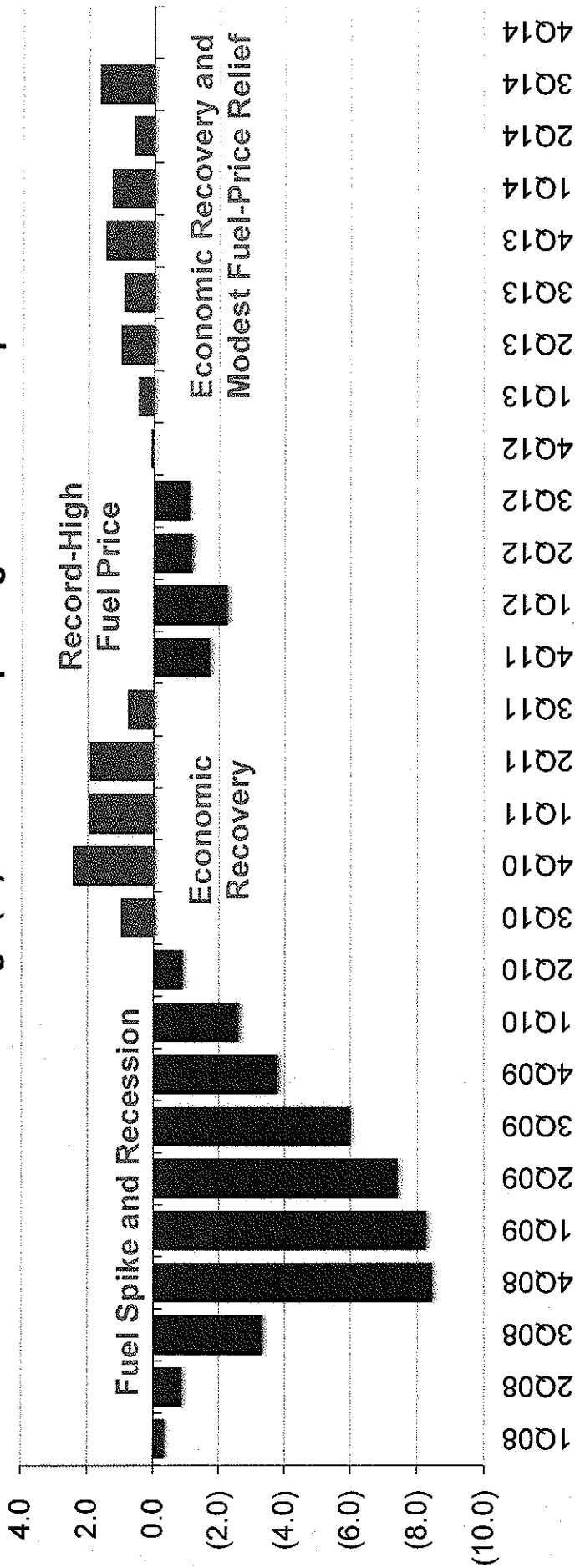


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As Airlines Generate Modest Returns on Capital, Customers Are Seeing More Seats Scheduled to Depart from U.S. Airports – Two Years’ of Growth

“We’d like more flights. But you’re not going to have any flights if the airlines don’t make money, so we understand their predicament.” (Larry Cox, president and CEO of the Memphis-Shelby County Airport Authority, “Regional airlines face closings, bankruptcy,” *USA Today*, Aug. 20, 2012)

Year-Over-Year Change (%) in Seats Departing from U.S. Airports



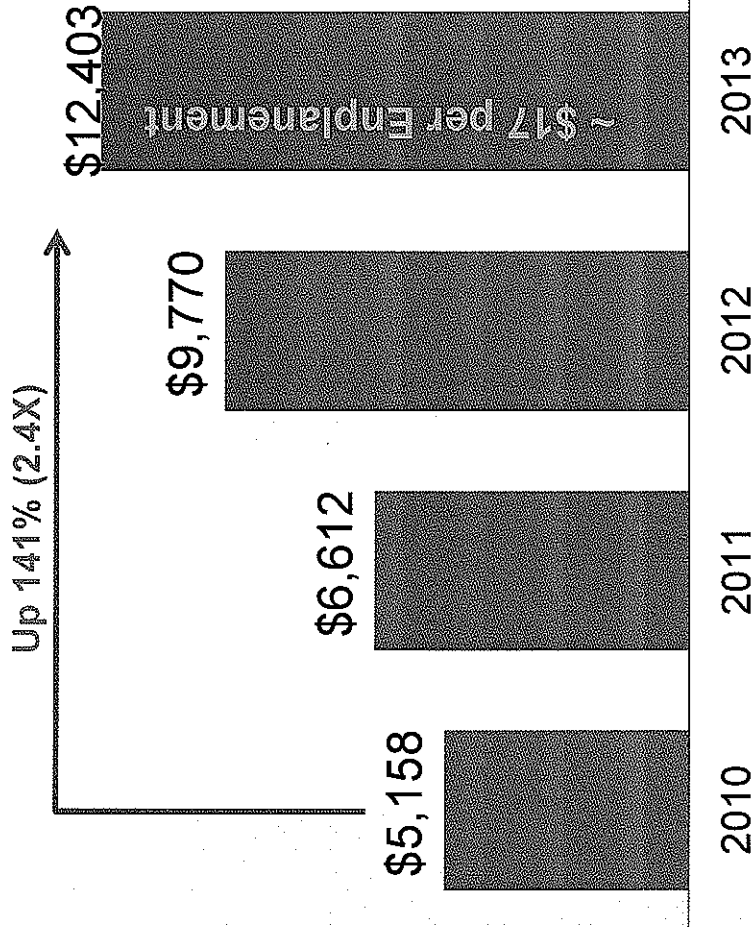
Source: Innovata (via Dijo Mi) published schedules as of May 2, 2014 for all airlines providing scheduled passenger service from U.S. airports to all destinations



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Improving Finances Enabling Significant Reinvestment in Customer Experience
 Airline CapEx Up ~141% Since 2010, with Plans to Invest an Additional \$12B in 2014

U.S. Airline* Capital Expenditures (\$ Millions) Planned 2014 Capital Expenditures: \$12B



- » Aircraft, engines, winglets, spare parts
- » Ground equipment, loading bridges
- » Airport facilities, aircraft hangars
- » Premium seats, new aircraft interiors
- » Maintenance facilities and machinery
- » Bag carousels, carts, scanners
- » In-flight entertainment and Wi-Fi
- » Computers, kiosks, mobile technology

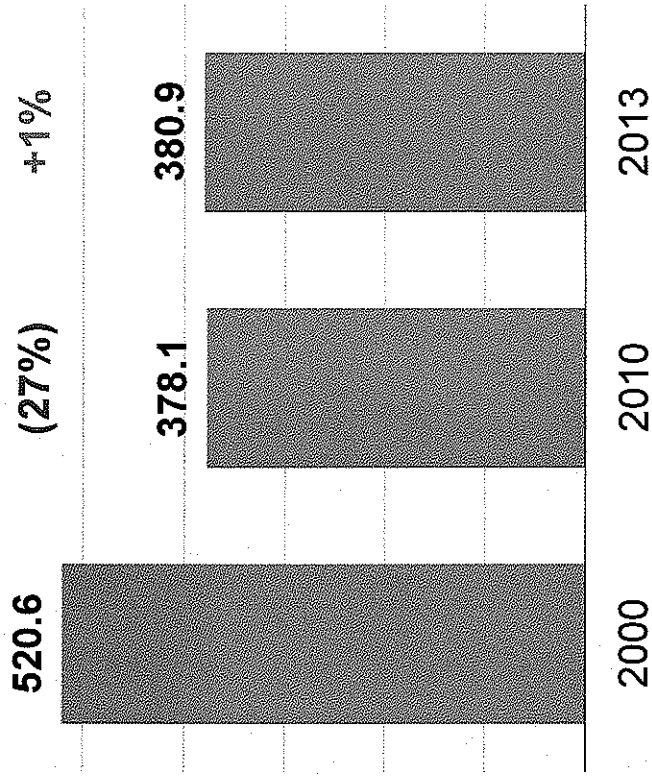
* SEC filings of Alaska, Allegiant, American/US Airways, Delta, Hawaiian, JetBlue, Southwest, Spirit and United



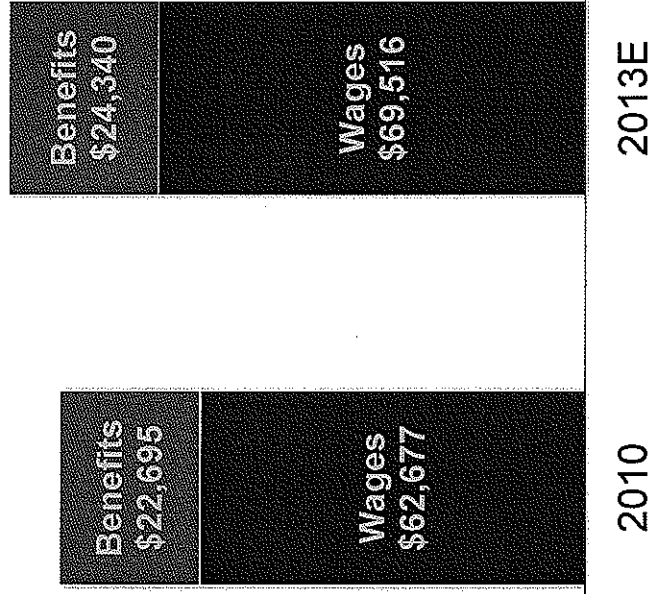
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After a Decade of Sharp Workforce Reductions, U.S. Passenger Airline Employees Saw Jobs Grow and Wages and Benefits Rise From 2010 to 2013

Employment
Thousand FTEs

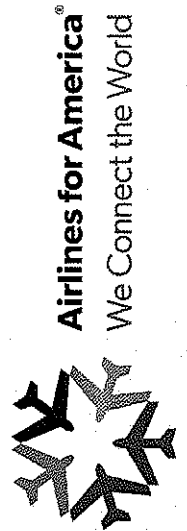


Wages & Benefits
Annual Average per FTE

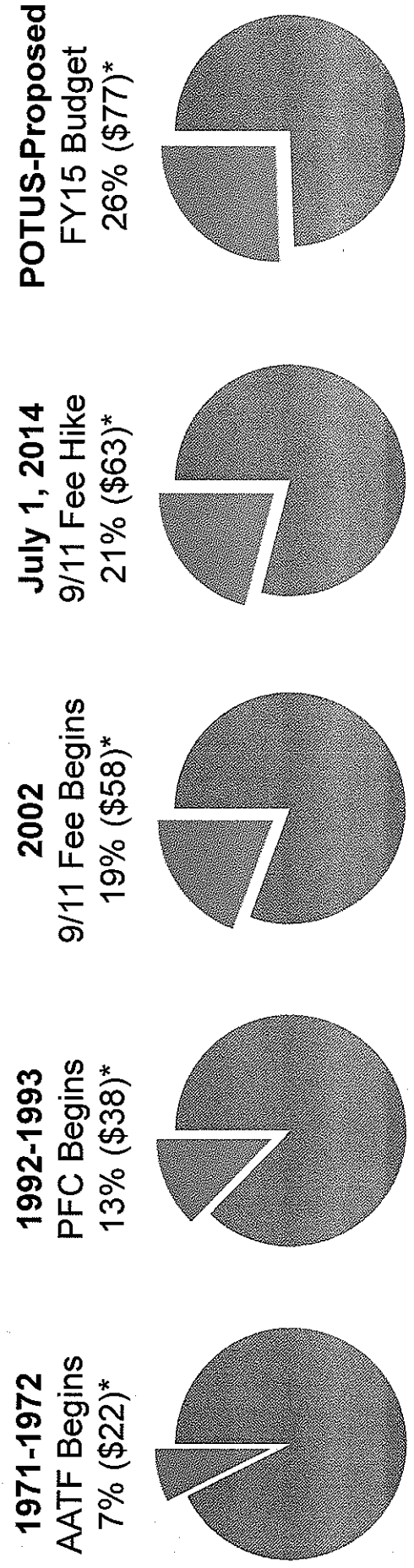


Total = \$85,372 Total = \$93,856

Source: BTS and A4A Passenger Airline Cost Index



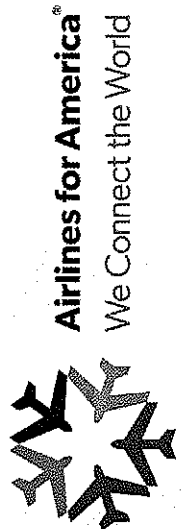
U.S. Ticket Taxes on \$300 One-Stop Domestic Round Trip* Keep on Rising
 U.S. Commercial Aviation Tax Burden* Reached Record-High \$19.3B in 2013; Growing Federal Take – Higher Than on Alcohol or Tobacco – Leaves Less for Carriers to Reinvest



■ Taxes ■ Airfare

AATF = Airport and Airway Trust Fund

* Sample itinerary is a domestic round trip with one stop each way and maximum passenger facility charge (PFC) per airport; total ticket price includes taxes
 Source: A4A analysis of federal tax code, including IRS Revenue Bulletin 2013-47, Rev. Proc. 2013-35, Bipartisan Budget Act of 2013, and President's FY2015 budget



Promoting Growth in the Aviation Sector Would Help Grow Michigan's Economy

- Since the most recent U.S. recession began in Dec. 2007, airline capacity has tracked very closely with changes in the strength of the economy and changes in the price of jet fuel, including taxes
 - When airlines are profitable, they grow the number of flights and/or seats offered and passengers served, and they reinvest in their people and products; this in turn translates to significant economic and employment gains for hub states
 - FAA economic analysis has found that for every 100 airline jobs, an estimated 473 jobs are supported outside the industry both directly and indirectly
 - Airlines develop routes, determine frequencies and allocate aircraft around the globe based not only on the expected revenue to be generated but also on the costs of operating that service
 - The cost of doing business is particularly important on routes that are marginally profitable (or unprofitable), and those routes are often those that serve small and mid-sized communities
 - With great variation in costs (including taxes) across hubs, airlines are continually faced with hard choices not only about whether to cut or grow, but also where to cut or grow; promoting more aviation growth through lower costs in Michigan would help encourage more flights, more jobs and more revenues throughout the state
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Impact of Fuel on Delta Air Lines

- Jet fuel is Delta's single largest operating expense (about 35% of operating costs, or \$12B)
- Delta's fuel bill grew was \$11.7 Billion in 2013
- Every \$1 increase in the cost of a barrel of oil equates to a roughly \$100M increase in the annual cost of fuel
- In recent years, price volatility for fuel has increased dramatically, making planning for fuel cost increasingly difficult
- Delta's fuel management strategy is all encompassing
 - Hedging program
 - Self-management of long term contracts and delivery
 - Aggressive conservation programs both on the ground and in the air
 - Airspace redesign initiatives in partnership with FAA
 - Purchase of oil refinery in Trainer, PA



Fuel Tax Burden in Michigan

- » **Michigan fuel tax rates:**
 - » Sales tax: 6%
 - » Excise tax: 3.0 cents per gallon (cpg), less 1.5 cpg credit for fuel purchased for interstate flights
 - » Underground Storage Tank Fee: 0.875 cpg
 - » Combined effective rate (at a fuel price of \$3.00 per gallon): 20.4 cpg

- » **Based on a fuel price of \$3.00 per gallon, estimated annual Michigan fuel tax liability is approximately \$36M, comprised of:**
 - » Sales tax: \$31.8M
 - » Excise tax: \$2.7M
 - » Environmental tax: \$1.5M

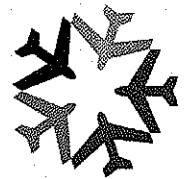
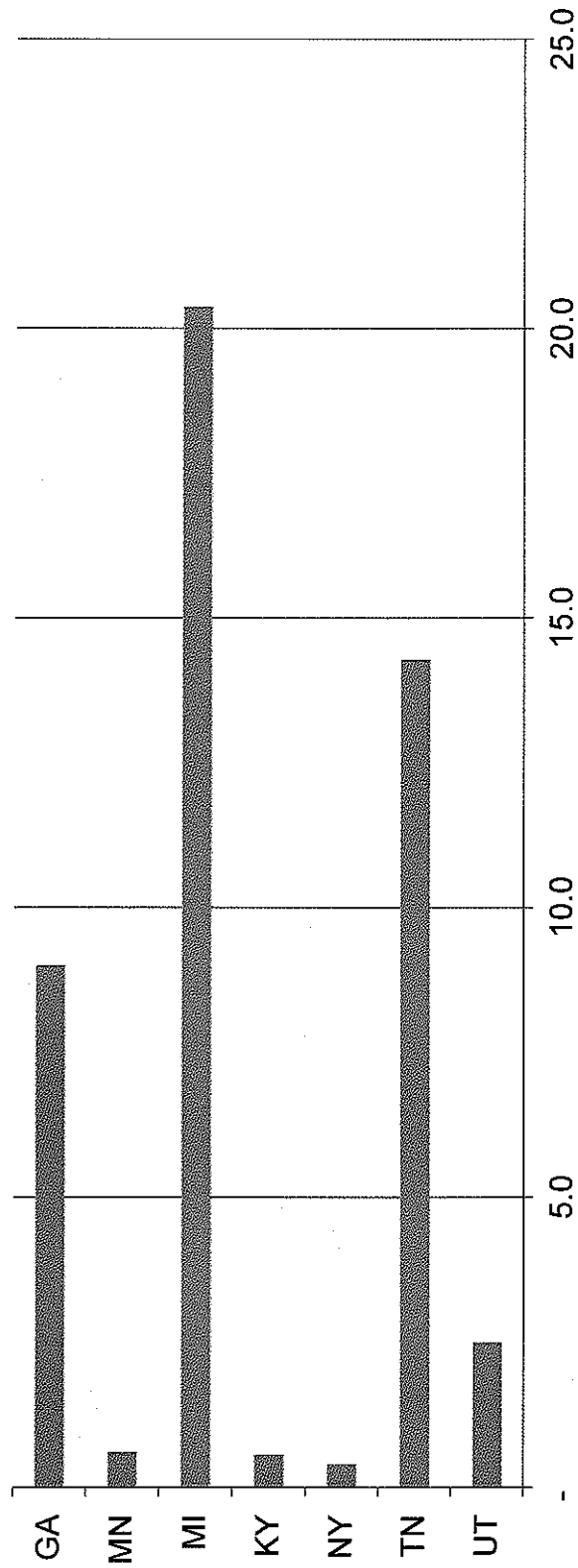
- » **Michigan fuel taxes increase Delta's cost of fuel in Michigan by 6.25%**
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Michigan Taxes on Jet Fuel Highest of all Delta Hubs

State Sales and Excise Taxes on Jet Fuel in Cents per Gallon

*Base Price of Jet Fuel: \$3.00



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Michigan Has the Highest Effective Tax Rate of all Delta Hubs

Georgia

- 3% sales tax (rate effective July 1, 2012)
- In April 2012, at Delta's request, the GA Legislature reduced the state tax on aviation fuel from 4% to 3%, the rate in effect in 1987

Minnesota

- 0.5 cent per gallon excise tax (over 200,000 gallons), plus 0.1 cent per gallon environmental fee

Kentucky

- 7% sales tax (capped at \$1 million per year)

Tennessee

- 4.5% sales tax
- » 1.4 cents per gallon excise tax on fuel burned in Tennessee and 1/20 cent per gallon excise tax on fuel exported

New York

- » 6.8 cents per gallon excise tax, but only applied to fuel burned in New York, reducing the effective rate on fuel purchased in New York to less than 0.5 cent per gallon

Utah

- » 2.5 cents per gallon excise tax
-



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Michigan's Tax Burden Puts Delta at a Competitive Disadvantage to Other Airlines

» Colorado (Hub for United and Southwest)

- Sales tax: 2.9%
- Excise tax: 4 cpg (City of Denver)

» New Jersey (Hub for United/Continental)

- No sales tax on jet fuel
- Excise tax: 4 cpg, but applied only to fuel burned in New Jersey (effective tax rate on fuel purchased in NJ is less than 0.5 cpg)

» Texas (Hubs for American, United/Continental and Southwest)

- No sales tax
- No excise tax

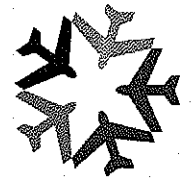


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Delta Helps Michigan's Economy Soar

- » **When Delta does well, so do our customers, the communities we serve and our employees. In 2012:**
- » Annual customer spend for DTW Delta customers alone is \$2.2 Billion annually both inside and outside the airport, not including airline ticket sales
- » Delta activity at DTW generates over \$210 Million in annual tax revenue for the State of Michigan
- » Paid out \$598 Million in profit sharing and \$91.7 Million in Shared Rewards to our employees worldwide.
- » Over \$56 Million in Detroit profit sharing alone
- » Slight growth in available seat miles out of DTW YoY

* 2012 Profit sharing paid in 2013



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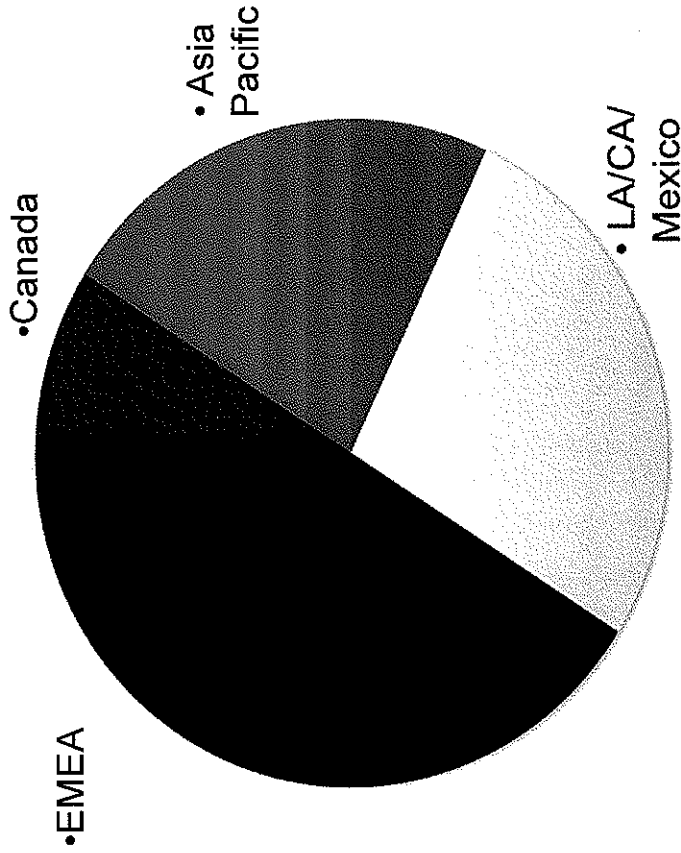
Delta Facilitates Global Commerce for Michigan Businesses

Thousands of Michigan businesses fly Delta

- Delta has 121 Corporate Accounts in Michigan
 - Includes account relationships with most large businesses in the state
- Delta has 4,700 SkyBonus Accounts in Michigan
 - Delta rewards small- and medium-sized companies through the SkyBonus program
 - The company earns SkyBonus points while the traveler simultaneously earns SkyMiles
- Countless other Michigan small companies and independent business people rely on Delta to serve their commercial needs

Delta takes Michigan business around the world

Delta International Corporate Account Trips From Detroit



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Make Michigan More Competitive

- Pass HB 4571, 4572 and 4677
- Lower the effective tax rate on jet and aviation fuel
- Put revenues from jet fuel and aviation fuel into the State Aeronautics Fund



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Federal Preemption

- Federal law prohibits the expenditure of state and local taxes on aviation fuel (except taxes in effect on December 30, 1987) for non-airport or non-aviation purposes *
- Proposal A increased the then existing 4% sales tax in Michigan by an additional rate of 2% beginning in 1994, and the proceeds are dedicated to state school aid pursuant to the Michigan Constitution
- The statute implementing Proposal A did not exempt aviation fuel, and the 2% tax is inconsistent with federal law
- In 1999, the FAA issued its *Policies and Procedures Concerning the Use of Airport Revenues*, 64 Fed. Reg. 7696
 - State or local taxes on aviation fuel (except taxes in effect on December 30, 1987) are considered to be airport revenue subject to the revenue use requirement. *Policy* at II.B.2.
 - Unlawful revenue diversion is the use of airport revenue for purposes other than the capital or operating costs of the airport, the local airport system, or other local facilities owned or operated by the airport owner and directly and substantially related to the air transportation of passengers or property, when the use is not 'grandfathered' under 49 U.S.C. § 47107(b)(2). *Policy* at II.C.

* 49 U.S.C. § 47133. Restriction on use of revenues



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