

rex. *Regional Express*

*Regional Express Submission to the
Senate Standing Committees on Rural and
Regional Affairs and Transport*

*Inquiry into the operation, regulation and funding of air route
service delivery to rural, regional and remote communities*

February 2018



Regional Express (Rex) submission into the operation, regulation and funding of air route service delivery to rural, regional and remote communities

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1 BACKGROUND

Regional Express (Rex) was founded in 2002 as the merger of Ansett subsidiary airlines Hazelton and Kendell following the collapse of Ansett in 2001. Both Hazelton and Kendell airlines had over 30 years experience prior to the collapse of Ansett.

Rex is a dedicated regional airline that operates 53 Saab 340 turbo-prop aircraft (34 seats) to 58 destinations throughout Western Australia, South Australia, Victoria, Tasmania, New South Wales and Queensland. Rex carries around 1.2 million passengers on some 75,000 flights per year. Rex is a publicly listed company on the ASX.

Rex with its more than 45 years of experience in regional aviation, the largest number of regional routes of any operator and the winner of the most State Government tenders for regulated routes is without doubt the pre-eminent authority on the operation, regulation and funding of air route service delivery to rural, regional and remote communities and welcomes the opportunity to share our experience on these matters and our proposals on the effective measures that could be taken to reduce significantly the cost of regional airfares.

Rex possesses great experience in servicing sparse population centres with most of regional centres on its network having a population of fewer than 30,000 with the largest regional city having only around 60,000. As a dedicated regional airline Rex is solely focused on the provision of regional air services.

Over the past 15 years Rex has been very successful in growing regional passenger numbers to record levels with Rex's annual passenger numbers growing from around 600,000 in 2002/03 to around 1.2 million currently. This has been achieved through keeping fares affordable, focusing on efficiencies and on-time performance, all with heartfelt country hospitality. Since 2002/03 the average Rex ticket price has only increased by 1.1% per annum which is a testament to Rex's commitment to simplicity, efficiency and good value.

In addition to Rex's focus on service reliability, Rex is mindful of the tremendous social and economic impact its services have on the regional communities and strives to work in partnership with these communities to balance their needs against the imperatives of providing a sustainable and safe regional air service.

Rex is also committed to giving back to regional communities by supporting worthy charitable causes which are focused on helping those in need. In FY17, which is typical of prior years, Rex contributed over \$330,000 thousand to various worthy causes ranging from fundraisers and sponsorships to important community events around Regional Australia. Rex also places a high priority on supporting cases of hardship, particularly out in the regions.

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Rex has frequently been recognised as the world’s best regional airline by aviation experts, which includes being named Asia Pacific Regional Airline of the Year for 2017, for the fourth time, by CAPA Centre for Aviation.

Rex Regular Public Transport (RPT) Network



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2 REX IN NSW, VIC, TAS & SA (TRADITIONAL NETWORK)

Rex's traditional network is a hub and spoke operation out of Sydney, Melbourne & Adelaide airports. It is largely the network of the Rex's predecessor airlines of Hazelton and Kendell airlines.

In NSW, intrastate routes with less than 50,000 annual passengers have historically been licensed to a single operator. The NSW Government has deregulated some routes and the remaining routes (with the exception of Lord Howe Island) will be deregulated beyond March 2018. Rex has always supported the deregulation of NSW intrastate routes Rex's past submissions to the NSW Government are publicly available.

There is no regulation in VIC/TAS. The number of intrastate services in VIC is limited to the Melbourne to Mildura route, serviced by Rex, QantasLink and Virgin Australia. Rex links the Tasmanian ports of Burnie and King Island to Melbourne. Rex links the NSW ports of Albury, Merimbula and Wagga Wagga to Melbourne. Rex links the SA port of Mount Gambier to Melbourne.

In SA, only the single route of Adelaide to Port Augusta is regulated. Rex holds the license to service the Adelaide to Port Augusta 3 times per week having commenced services on 11 September 2017 following the prior operator withdrawing services in May 2017. The regulation does not influence the way in which Rex services the route and in line with Rex's views in NSW Rex does not see any value that is derived from licensing a thin and marginal route to a single operator when it struggles to support a single operator and therefore could never support competition.

3 REX IN QUEENSLAND

The QLD Government has an enlightened approach with the most successful, innovative and progressive programme that Rex has been involved with to date.

As part of a competitive tender process, the QLD Government has regulated 7 routes of which 5 routes were awarded to Rex with effect from 1 January 2015. The current 5 regulated routes operated by Rex are as follows;

- Western 1 (W1): – Brisbane, Wellcamp, St George, Cunnamulla, Thargomindah;
- Western 2 (W2): – Brisbane, Wellcamp, Charleville, Quilpie, Windorah, Birdsville, Bedourie, Boulia Mount Isa;
- Northern 1 (N1): – Townsville, Winton, Longreach;
- Northern 2 (N2): – Townsville, Hughenden, Richmond, Julia Creek, Mount Isa
- Gulf: Cairns, Normanton, Karumba, Mornington Island, Burketown, Doomadgee, Mount Isa.

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Rex commenced the N1 and N2 routes from Townsville in February 2010 which followed the collapse of regional airline MacAir in early 2009.

Shortly before commencing the N1 & N2 routes in February 2010, Rex commenced a competitive service between Townsville and Mackay on 1st October 2009. However in December 2009 Rex announced that it was forced to exit the Townsville to Mackay route after lodging a formal complaint with the Australian Competition & Consumer Commission (ACCC) against QantasLink over its practices on the route. In response to Rex's debut entry into North QLD, QantasLink slashed their entry level fare by around 35% and added an extra 40,000 annual seats to the Townsville to Mackay route within weeks of Rex's commencement.

Also in February 2010 Rex launched a non-regulated non-stop service between Mount Isa and Townsville to once again bring a competitive air service to North QLD with QantasLink previously being the sole carrier on this route. Rex commenced the direct Mount Isa to Townsville service in response to the persistent pleas from the local community for an air service to Townsville that is affordable and which has a business-friendly schedule.

Unfortunately Rex's Mount Isa to Townsville service was not supported and Rex was forced to exit in early 2015 following significant financial losses being incurred.

On 1 January 2015 Rex launched a direct non-regulated service between Cairns and Mount Isa. On 3 January 2015 Rex commenced a new non-regulated competitive air service between Cairns and Townsville in competition with QantasLink. This coincided with the commencement of the 5 QLD regulated routes with effect from 1 January 2015 and the subsequent establishment of a Rex base in Cairns.

Ever since Virgin Australia exited the Cairns to Townsville route, Rex had been solicited to commence a competitive air service on the route to end the QantasLink monopoly. Rex had previously not been able to respond however the awarding of the Gulf route (to/from Cairns) to Rex from 1 January 2015 gave Rex the natural impetus to provide the competitive service between Cairns and Townsville.

In partnership with the Northern Peninsula Area Regional Council (NPARC), Rex then commenced another non-regulated air service between Cairns and NPA airport (Bamaga) with effect from 30 March 2015. This followed Rex inviting interested Cape York communities to express their interest with Rex, following the initial collapse of Skytrans airlines. The Rex Board moved quickly to approve the commencement of services between Bamaga airport and Cairns due to the NPARC's willingness to forge a mutually beneficial partnership with Rex to ensure the sustainability of a safe, reliable and reasonably priced regional air service for the region.

In addition to the five regulated routes, Rex continues to operate the non regulated services linking Cairns to Mount Isa, Townsville (competitive with QantasLink) and Bamaga.

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In January 2018 Rex introduced the “Rex Community Fare” Scheme on the Mount Isa to Cairns route. The \$198 “Rex Community Fare” is made available on up to 30% of seats on every direct flight between Mount Isa and Cairns if booked at least 30 days prior to departure. Furthermore, **all unsold seats** one day prior to departure will be available at the Rex Community Fare level.

The scheme provides the local community with access to affordable fares when planning travel in advance or, more importantly, when last-minute travel is required, when fares can be at the highest. The Rex Community Fare is available to anyone, and does not come with the administrative burden associated with providing proof of residence.

Mount Isa Airport has partnered with Rex for this initiative, with the provision of reduced airport charges for each Community Fare sold through until 30 June 2018. Rex will commit to extending the Community Fare between Mount Isa and Cairns into FY19 subject to the continuation of the arrangement with Mount Isa Airport. Regrettably, Cairns Airport was not willing to support this initiative, which was designed to assist the less fortunate.

The Rex Community Fare Scheme, which was first implemented by Rex in WA on the Albany - Perth and Esperance - Perth routes, has since been introduced in the communities of Broken Hill, Burnie, Moruya and Parkes under mutually beneficial partnership agreements between Rex and the local councils. The continued roll-out of the Rex Community Fare Scheme across the Rex network demonstrates the initiative’s success in providing regional and remote communities with more affordable air travel.

4 REX IN WESTERN AUSTRALIA

On 28 February 2016 Rex commenced the Perth Albany and Perth Esperance routes under a Deed of Agreement with the Western Australian (WA) government. This confers onto Rex the sole right to operate on the Perth Albany and Perth Esperance routes for a five year term beginning on 28 February 2016. This was a major milestone for Rex as it resulted in Rex establishing operations in WA for the first time.

From Perth Rex operates 23 weekly return services to Albany and 18 weekly return services to Esperance. The Albany route has around 56,000 annual passengers and the Esperance route has around 50,000 annual passengers.

Rex has 4 Saab 340 aircraft based in Perth of which 2 aircraft are allocated to the Albany and Esperance flight schedules, 1 aircraft is a dedicated back-up aircraft and the last aircraft used for maintenance and adhoc charter.

Rex has flight crew and engineering staff that are based in Perth and contracted airport ground handling arrangements in Perth, Albany and Esperance.

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Shortly after commencing the Albany and Esperance service Rex set about lowering fares through the introduction of a revolutionary Community Fare scheme in partnership with the City of Albany, the Shire of Esperance and Perth Airport. The Community Fare is priced at \$129 fully inclusive for both the Albany and Esperance routes. In calendar year 2017 more than 10,000 community fares were sold on each route which represents around 20% of total passengers on the route and about \$1.5m savings for the community based on the average fare.

The scheme has been so successful that all of the stakeholders have signed on for a 3-year extension of the scheme through until 30 June 2020. To achieve the \$129 fully inclusive price for the customer, Rex has to lower its core fare to \$63 (Albany Perth) and \$73 (Esperance Perth) in order to accommodate the airport charges at Albany, Esperance and Perth. This is a significant investment undertaken by Rex to make fares more affordable and to stimulate passenger growth.

In late December 2017 Rex was awarded the preferred tenderer to service the Perth to Carnarvon and Monkey Mia (Shark Bay) route with effect from July 2018. This is subject to the execution of the Deed of Agreement between Rex and the WA Government.

5 FACTORS CONTRIBUTING TO CURRENT HIGH COST OF REGIONAL AIRFARES

5.1 INHERENT INEFFICIENT NATURE OF REGIONAL AIR SERVICES

The dynamics of regional air travel inevitably results in higher ticket prices:

- Thin passenger numbers are often less than 40,000 pax a year
- The need for day return capabilities for passengers originating from both the regional centre and the capital city. This means that:
 - o Aircraft needs to overnight in the regional centre to allow for early morning departure 6.30 a.m.
 - o Minimum 3 returns needed otherwise the capital city based aircraft and crew will be left stranded in the regional centre.

These factors result in extremely high inefficiencies with load factors typically in the 55-60% range when typical jet operators need at least 75% load factor to break even and even over 80% for the low cost carriers.

Rex would like to state categorically for the record that, contrary to popular folklore, competition in regional aviation can be particularly detrimental for all the smaller routes of less than 100,000 passengers a year. Competition does not ultimately result in lowering prices as Rex's vast experience has shown and in fact can destroy efficiencies and result in higher airfares and lower profits (or bigger losses) for all concerned as well as a reduction of real frequencies.

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A case in point is the example of the Adelaide to Port Lincoln route in SA. Before the entry of QantasLink (QL), Rex was servicing the port with up to 10 return flights per day. After QL's entry, Rex now has only 6-7 returns a day and the average Rex airfare is 30% higher than what it was before QL's entry 7 years ago. This is because with the lower load factor that both carriers now face, higher average fares are required to compensate for the lower load factors and higher inefficiencies. The end result is negative for everyone – the community has fewer real schedule choices (QL's 3-4 returns essentially mirrors Rex's schedules) and the customer has to pay a higher ticket price while the carriers see their profit margins at barely sustainable levels. The Adelaide to Port Lincoln route has around 175,000 total annual passengers.

Regional aviation is inherently more expensive than domestic or international aviation due to the poor economies of scale associated with needing to respond to regional dynamics highlighted earlier. The operating costs for a regional carrier are around 3 times higher on a per seat basis than a larger carrier operating larger jet aircraft on significantly higher volume passenger routes.

Even with Rex's high level of efficiency associated with operating more than 50 aircraft on 75,000 flights per year, Rex's FY 16 operational profit before tax amounted to only \$4 per passenger per flight hour of over 400 km. This means that on a ticket price of about \$200, a \$5 reduction in average fare would put Rex out of business. A taxi driver at any Capital City would make more profit carrying a passenger between the Capital City Airport and the CBD than Rex on a 350km flight.

5.2 HIGH AIRPORT CHARGES

5.2.1 REGIONAL AIRPORTS

Rex operates to more than 50 regional airports across Australia, with the vast majority being owned by local councils. Regional airports were vested to the local councils at no cost (often with a large sum to offset future maintenance costs) by the Federal Government prior to 1991.

Regional airports are a vital piece of community infrastructure and form a valuable community asset and should be treated no differently than local roads and bridges as critical local infrastructure that has broad ranging benefits across the entire council municipalities. Yet, most regional airports adopt a user pays approach that requires the 'airport business' to stand-alone at no cost to the council (ratepayer) and in many cases generate a healthy surplus back to council.

Many councils argue that a \$3 increase in head tax is not such a big deal compared to the overall \$200 cost of the ticket. As explained earlier, \$3 is extremely significant compared to the \$4 that Rex made for each passenger.

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Rex can see three main areas of concern in regards to regional airport monopolistic behaviour;

1. Generation of excessive revenue surplus via the airport head tax revenue stream and using this to fund the local Council's other losses.
2. Building of grandiose airport terminals that exceed the current and forecast requirements of the airport which result in high annual depreciation overheads.
3. Expansion of runways, taxiways and apron to cater for larger jet aircraft that exceeds current and future requirements of the airport, again resulting in high depreciation.

The 'build it and they will come' approach comes with extremely high risk. Developing regional airports should be undertaken with a phased and rational approach and questions do need to be asked when some regional airports embark on such plans (to accommodate wide-body jets such as A320 and 737) when the regional airports current and forecast demand can be readily accommodated with turbo-prop aircraft that don't require the massive infrastructure spend.

Many regional airports have not placed appropriate revenues into necessary sinking funds for the major capital investment that will be required in maintaining and upgrading airport infrastructure and years later seek to recoup this mismanagement through increasing airport charges to the detriment of regional airlines and regional customers.

Regional airports are dynamic with ever-changing passenger throughput and activity levels. In a competitive environment, regional airports should consider passenger and activity growth (and subsequent improved airport efficiencies) rather than simply applying routine CPI increases to airport charges. Many local councils do not acknowledge the simple logic that it is airport revenue growth that is important and not the airport charges growth.

If the regional airport passenger numbers have grown significantly, which in turn has increased airport head tax revenue (in many cases by much more than CPI) then it defies economic logic for a council to state that due to its airport charges (head tax) not increasing for a number of years that this then represents a "fee reduction in real terms".

Regional airports should be aiming to share the improved airport efficiencies and economies of scale by reducing the airport unit rate charges in order to assist with air service viability and affordability of fares to the benefit of their local community. However many councils adopt a one dimensional view that any reduction in unit rate costs is considered to be a subsidy or a rebate "at the expense of the ratepayer". This is simply not correct when airport revenues are growing incrementally and in many cases at much higher rates than CPI

Across Rex's vast regional network there is much contrast in the approach that is adopted by regional airports. There are those that truly value their regional air service, whilst others chose to embark on grand plans based on the 'build it and they will come' approach or a cash cow approach.

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An example of regional airport monopolistic behaviour is at Mount Gambier airport in South Australia, which also follows a 'build it and they will come' philosophy.

Mount Gambier airport (owned by the District Council of Grant) unilaterally imposed a hefty 46% passenger head tax increase on to Rex during FY11, which followed subsequent increases of 9% and 8% during FY09. Such unjustified increases in the passenger tax (in spite of the fact that airport revenues had grown significantly because of the increased throughput of Rex passengers) have a significant impact on ticket pricing and a subsequent impact to passenger demand.

In 2010, at the time of the 46% head tax increase, the District Council of Grant communicated that the unilaterally decided increase was necessary "to cater for charter planes and larger aircraft like QantasLink which presently cannot land here" and that "Port Lincoln (SA) already has QantasLink and as a regional airport we also deserve to have this ability".

Rex warned the District Council of the predicted outcomes, stating that;

"the council's actions were economically and socially irresponsible as the community will end up paying for the additional costs through higher ticket prices. This will have a negative downward spiral effect as higher fares will mean fewer passengers which in turn will translate into a reduction of services which in turn will lead to a further reduction of passengers" and "In the not too distant future the District Council will have to explain to the community why it had spent millions on additional airport infrastructure to welcome an ever decreasing number of passengers"

As predicted by Rex, the District Council of Grants irresponsible decisions during the period 2007 – 2010, which sky-rocketed the airport head tax by more than 50%, resulted in a steep decline in passenger numbers from 117,000 then down to around 76,000 today. Sadly the 76,000 passengers today are generating more airport head tax revenues for Mount Gambier airport than the 117,000 passengers did in 2007/08.

Despite having seen 40,000 fewer passengers a year, the District Council of Grant still wants local ratepayers to believe that there will be a long queue of airlines wanting to operate to Mount Gambier. Unfortunately this is a pipe dream that Rex has witnessed many times over the past decade in several communities, and every single one has ended as a white elephant.

The facts of the matter is that the Mount Gambier to Adelaide route has around 45,000 passengers per year with the Mount Gambier to Melbourne route achieving around 31,000 passengers per year. Routes this size cannot sustain competition.

On the other hand, Rex also encounters great examples of collaborative partnerships between the airline and the council. Rex, in partnership with Parkes Shire Council has grown the Parkes to Sydney passenger numbers from around 12,000 to 30,000 per year since FY03. This involved setting passenger thresholds that, once exceeded, result in a lower airport passenger tax. During

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the important building years that required significant Rex investment and commercial risk, the partnership arrangements provided Rex with the necessary incentive to undertake a longer term approach to grow the market that would not have been possible in the absence of such collaboration. This enabled Rex to transition the Parkes to Sydney route with from a 19 seat aircraft to a 34 seat aircraft, triggering increased capacity, improved flight schedules and more affordable fares achieved through improved efficiencies and lower unit costs. At the same time, Parkes airport revenue continues to grow and more importantly the Parkes Shire benefits from the tremendous social and economic benefits that flow from the improved air service.

Rex currently has a 5 year partnership agreement with Parkes Shire Council whereby Parkes airport is guaranteed annual airport revenue with annual CPI growth, regardless of the passenger numbers. This gives the airline cost certainty and the airport revenue certainty. It also provides the airline with an incentive to grow passenger numbers because if passenger growth exceeds CPI then it improves the airlines operating efficiencies.

As a result of this very successful partnership Rex has recently introduced the "Rex Community Fare" scheme on to the Parkes Sydney route. The \$99 Rex Community Fare scheme between Parkes and Sydney will see the community fare made available outside of 30 days prior to departure subject to availability, in addition to all remaining unsold seats being made available within 1 day prior to departure. The Rex Community Fare scheme will be in place through until 30 June 2022 which mirrors the 5 year term of the partnership agreement between Rex and Parkes Shire Council.

In 2017 the WA Government conducted a Parliamentary Inquiry into regional airfares. The inquiry was undertaken by the Economic and Industry Standing Committee (WISC). Rex provided a comprehensive submission to the EISC as well provided further verbal evidence at a public hearing.

The Rex submission and hearing transcript can be viewed at the following links;

[http://www.parliament.wa.gov.au/Parliament/commit.nsf/\(Evidence+Lookup+by+Com+ID\)/7B169BC5E2664814825817D002CBA55/\\$file/20170728+-+REGAIR+-Sub+57+-+Regional+Express.pdf](http://www.parliament.wa.gov.au/Parliament/commit.nsf/(Evidence+Lookup+by+Com+ID)/7B169BC5E2664814825817D002CBA55/$file/20170728+-+REGAIR+-Sub+57+-+Regional+Express.pdf)

[http://www.parliament.wa.gov.au/Parliament/commit.nsf/\(Evidence+Lookup+by+Com+ID\)/C8E55A177693F9E3482581AA002BD354/\\$file/EISC+20170913+-+Regional+Express+\(Rex\)-+FINAL.pdf](http://www.parliament.wa.gov.au/Parliament/commit.nsf/(Evidence+Lookup+by+Com+ID)/C8E55A177693F9E3482581AA002BD354/$file/EISC+20170913+-+Regional+Express+(Rex)-+FINAL.pdf)

Also in WA, the Department of Transport is in the process of formulating a Strategic Airport Asset and Financial Management Framework for regional airports. The aim is to have a standardised template for asset management that can also assess the determination of fees and charges. Regional airports that seek funding through the WA Governments Regional Airports Development Scheme (RADS) will also be required to participate in order to be eligible for funding.

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Rex believes that this is a great initiative by the WA Government as it will foster an open and transparent approach. It will also ensure that the WA Government allocates regional airport funding to airports that are in the most need or has the best economic justification. The process will provide the WA Government with invaluable information about regional airports from throughout the State and this information can be used to better understand the challenges faced by regional airports and in turn how the State Government can best assist. Rex recommends that other State Governments should adopt the same approach.

5.2.2 CAPITAL CITY AIRPORTS

Continued access by regional airlines to Capital City Airports remains critical to the sustainable provision of regional air services due to the essential nature of regional air travel. Regional communities depend upon on a reliable and sustainable regional air service for medical, business and government related travel. It is crucial to the socio-economic fabric of regional communities and the benefits are far-reaching across local, state and federal government levels.

There are several key issues with regards to capital city airports;

5.2.2.1 AIRPORT PRICING

Sydney airport is the only Capital City airport in Australia where Aeronautical services and facilities provided by Sydney airport to regional air services are declared under the Federal Governments Declaration no. 94. The current declaration commenced on 1 July 2016 and ceases on 30 June 2019. This was previously Declaration no. 93.

This important Declaration means that Sydney Airport must provide a price notification to the ACCC prior to increasing its prices for regional air services. This ensures that any increases to core Sydney airport pricing for regional air services is capped at CPI and must be submitted to the ACCC for scrutiny. This arrangement was enacted in 2002 as part of the Sydney Airport Sales Act.

In assessing any such notified price increases the ACCC must have regard to the Direction which requires that Sydney airport price increases relating to regional air services should not exceed the percentage increase in the Consumer Price Index (CPI) and the value of this ACCC was proven back in 2010 when Sydney Airport sought to impose massive and unjustified price increases on Rex. The end result was that that Sydney airport dropped the unjust proposal however without the Declaration and Direction, Rex would have been priced out of Sydney airport in 2010.

While Sydney Airport pricing is declared, all other capital city airports are not similarly regulated resulting in unbelievable high airport charges in places like Perth and to a smaller extent Brisbane and Melbourne. Regional air services are as equally critical and essential right across Australia and Rex believes that the all Capital City aeronautical services and facilities to regional air services should be declared under the Federal Governments Declaration no. 94.

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5.2.2.2 AIRPORT NON-PRICING PRESSURE POINTS

In addition to Capital City airport core pricing arrangements for regional air services being Declared, there are also additional protection measures required.

For example, a regional airline has a broad range of infrastructure requirements at a capital city airport. This includes hangar space to undertake necessary aircraft maintenance, office space for staff including airport staff and flight crew, ground support equipment storage areas, check-in desks and customer waiting areas, including airline lounges. These are all mandatory requirements for a regional airline to operate, yet they are not covered by any regulatory protection.

This leaves the smaller independent regional airlines highly exposed to both price increases associated with mandatory airport requirements and airport decision making that can lead to a significant negative impact to the airline and its customers. What maximises profitability for a Capital City airport may make an airline less efficient or add cost or reduce the quality of service and quite often all three of these outcomes are incurred.

Without regulatory oversight there is no 'check and balance'.

For example, the regional airlines arrivals area could be relocated requiring a greater walk for regional customers, inadequate access to ground transport and an inability to connect with other regional, domestic and international services. This has a commercial impact to the airline which is a real cost and in addition the airline incurs inefficiencies and additional staffing costs.

Regional airlines could also be directed to park aircraft in an area that is further away from the passenger terminal due to the prioritisation of larger aircraft. In the case of Sydney this requires additional bussing time (Rex owns 3 busses at Sydney airport with bussing cost of about \$800,000 a year) between the terminal and the aircraft with a consequential negative impact to on-time-performance due to the further distances and the busses having to cross live taxiways and hold for departing and arriving aircraft.

The airport does not offer any compensation for the deterioration of service levels, lost efficiencies and additional airline operating costs and in fact the airport attempts to impose additional aircraft parking charges due to the aircraft being directed to park in a General Aviation area.

5.2.2.3 ACCESS (INCLUDING SLOT AVAILABILITY)

At Sydney airport the protection of NSW regional slots recognises Sydney Airport's role as an essential transport hub for regional NSW.

The ring-fence protection of NSW regional slots formed part of the important legislative arrangements prior to the sale / privatisation of Sydney airport in 2002. The ring-fence protection

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of NSW regional slots was a result of the strong commitment of both Coalition and Labor Governments to ensure that regional NSW continues to have guaranteed access to air regional air services at Sydney airport and this important measure is enshrined in legislation.

Sydney airport tendered for the purchase of the airport on the basis of NSW regional slots being protected and would have accordingly reflected the legislated needs of regional NSW in their tender price.

Importantly, under the slots compliance scheme, all airlines have to comply with strict 'use-it-or-lose-it' provisions in order to maintain usage of the slots and this is equally applicable to the regional airlines operating with protected NSW slots. These historic precedence provisions require regional airlines to use at least 80% of their NSW regional slots in any given schedule period, otherwise the slots will be returned to the regional slot pool for alternative NSW intrastate regional usage.

It has been demonstrated that demand for NSW regional slots has been maintained between 2002 and 2018, as evidenced by the NSW regional slot pool being fully allocated in the legislated peak periods (6.00am – 11.00am and 3.00pm until 8.00pm) of operation at Sydney airport.

Under the Sydney Airport Demand Management Act, Sydney Airport is also constrained by the arbitrary movement cap of 80 movements per hour which does not reflect the true current capacity of Sydney airport. This arbitrary restriction was implemented more than 20 years ago in 1997, with only minor regulatory reform being applied during this period.

Whilst other Capital City airports (including Brisbane and Perth) have Slots or Runway Demand Management Systems (RDMS) in place, such systems are not legislated by Government.

In Rex's experience the risk is that Capital City airports can use a RDMS for commercial gain as opposed to using the system to fairly and equitably manage runway demand. This is done through the inclusion of "local rules" that unfairly treat smaller regional aircraft due to such aircraft representing a lower commercial return to the Capital City Airport.

An example of this was the RDMS implemented by Brisbane airport in 2013 that does not grant historical slot precedence for regular scheduled charter services for regional aircraft with less than 50seats. This means that an operator like Rex, who operates a 34 seat aircraft, cannot confidently bid for regular schedule charter work due to the airport slot uncertainty. Whilst an airport slot may be available at the time of the bid, it may be taken by a larger aircraft due to no historic slot precedence being accorded to the smaller aircraft.

Airports should not be allowed to use their monopoly position to achieve a better financial outcome than would be possible in either a competitive market or under regulated pricing. Rex does not believe that airports are presently subject to sufficient oversight. They can hide their

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conduct under the guise of rationales that, at face value, seem legitimate (eg legal requirements, safety, runway demand management schemes etc.) but in truth are not substantiated.

We have also seen examples of Capital City airports wanting to link a proposed RDMS with the aeronautical charges by saying that if the airline does not accept the airport charges then they won't be granted airport slots under the RDMS.

5.3 CASA

The overregulation by the Civil Aviation Safety Authority (CASA) is contributing to manpower and operating costs. Overregulation by CASA is a common frustration shared amongst the aviation community.

This requires REX to invest copious amounts of time and commercial resources into simply filling out, sending and monitoring paperwork for CASA expiries. This is evident in the application of crew medicals, which not only takes up to 28 days for CASA to process but also attracts a \$75.00 processing fee, on top of the actual medical examination. REX is of the view that such cost for simply processing a medical is unjustified. Further, the bureaucratic approval process for licence upgrades, training and checking approvals and synthetic trainer (simulator) approvals, results in diminished use of crew resources and vital check and training delays. These matters incur a higher cost to the airline operation and this is exacerbated by the current shortage of pilots.

For more than a decade, CASA has been on a path of regulatory reform in an effort to reduce the "red tape" and expedite processes within the organisation to the benefit of aviation industry and the public. This regulatory reform remains ongoing with little benefit realised to operators in recent times. Those reforms that have made their way into legislation have significantly differed from the associated Regulatory Impact statements. Furthermore, CASA does not employ a needs assessment based on local risks or evidence when reviewing, updating or adding to regulations. In REX's experience, the regulatory reform is in some cases unsubstantiated or is often in response to pressure from various interest groups (including unions) that aren't motivated by safe and affordable air transportation or perceived "best practice", neither cater for the visibility of regional airline operators. An example of this is seen in the pilot fatigue management rules – changes to which are unsubstantiated by evidence.

The implementation the following legislation has had significant financial impact to regional aviation:

- Part 61 has introduced an additional \$250,000 of cost per annum to REX's training costs
- Amendments to CAR 235A has added \$200,000 of infrastructure costs across the network
- Proposed changes to CAO 48 have the potential to increase operating costs by more than \$7 Million per annum

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- Recent runway lighting supplement requirements has the potential to add \$240,000 of infrastructure costs to the network

In the last five years, we have seen the largest exodus of aviation businesses and companies in the entire history of General Aviation (GA). [Benjamin Morgan CEO Aviation Advertiser Australia – 2016] The increased costs of bureaucratic red tape and “box-ticking” exercises have driven-up operating costs to beyond sustainable for small to medium operators.

The decline in GA operations across Australia over the last 10 years has:

- forced pilots out of the work following aviation businesses closing down;
- forced pilots out of the industry as work opportunities become scarce;
- forced pilots out of the industry due to concerns of job security; and
- discouraged young people from pursuing a career as a pilot.

Industry is now seeing the long term effect of this in the form of a pilot shortage as GA is where most of Australia’s airline pilots come from. It is only natural that a decline in GA operations will result in reduced pilot numbers. REX was able to foresee such issues as far back as 2007 when the company began the REX Pilot Cadet Program through its wholly owned subsidiary, the Australian Airline Pilot Academy (AAPA) based at Wagga Wagga in regional NSW. REX has invested more than \$35M in the AAPA training facility since 2007 and yet pilot shortages remains one of the businesses most challenging issues.

Another significant burden the aviation community has to shoulder is the fuel excise. According to the detail promulgated in CASA’s annual report for FY17, approximately 67% of CASA’s income was from aviation fuel excise. Aviation fuel excise, as published in the 2017-18 Portfolio Budget Statements, is expected to increase by 9.2% over the forward years. Rex contributed \$1.56M in the FY17 towards fuel excise and has contributed in excess of \$7M in the past five years.

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6 OTHER MAJOR THREATS TO REGIONAL AVIATION

6.1 REGIONAL AIRPORT SECURITY

The safety and security of our customers is paramount to our airline and Rex abides by all regulations as prescribed by the relevant governing authorities and will continue to do so if and when regulations change.

In the aviation world, there are several specialised agencies that constantly evaluate the most recent data and information to carry out risk assessments on all aspects of aviation. This constant evaluation ensures that our transport security system is fit for purpose and security measures are appropriate for the prevailing threat environment.

Rex believes that the risk assessment of air transport security risks is extremely complex and should best be left to the experts at the Office of Transport Security (OTS) who possess the latest security intelligence and who are constantly updating the risk assessments.

We are also of the view that Australia's response to terrorist threats must be balanced and measured and risk based. For example, smaller regional aircraft carry fewer passengers than most buses and it would be senseless to enforce screening on the former while leaving 'vulnerable' the tens of thousands of buses plying the streets each day. This example can easily be extended to trains, cinemas, shopping malls, restaurants, and the list goes on.

Terrorists will and do strike soft targets too as we have seen in the truck attacks in Nice and London, and the attack on a Sydney cafe. We must never ever give in to hysteria otherwise normal life will be paralysed without any real security benefit. Screening of all such potential targets would be so prohibitively expensive and onerous that normal life would be shut down.

To illustrate this in the context of Rex's network, Rex operates to 45 regional communities where airport passenger and baggage screening is not required. The annual operating cost associated with the provision of screening is about \$750,000 per annum at each airport location which means that regional air travellers will have to absorb an additional \$34M per annum in costs. The Rex Group's full year results (for the FY 16) only showed a \$4M operational profit, so it would be easy to see what would happen if screening were made mandatory - most regional centres would be left without an air service. Even its much improved FY 17 results only showed a statutory profit before tax of \$17.8M which would not be enough to keep operations going if Rex had to pay for the security charges.

The socio-economic impact of the loss of air services would be devastating to regional communities. Those needing to travel for essential medical, education and business reasons would be forced to drive and when they do, they would need to stop at cafes along the way for a break where they would presumably be screened too. Additionally, the millions of extra road users would undoubtedly add to the 1,200 road fatalities recorded each year in Australia.

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Giving in to hysteria is precisely the outcome that the terrorists seek and this would allow them to succeed in their objective of severely disrupting daily life without needing to carry out a single attack. Australia and Australians know better than to fall for their trap.

6.2 PILOT SHORTAGE AND VISA REQUIREMENTS FOR FOREIGN PILOTS

On 18 April 2017 the Department of Immigration and Border Protection announced wide-ranging changes to the Australian immigration program, including abolition of the Temporary Work (skilled) visa (subclass 457), which is to be replaced with a new Temporary Skill Shortage (TSS) visa in March 2018.

The changes see two occupations utilised by Rex completely removed from the official list of eligible occupations – Aeroplane Pilot and Aircraft Maintenance Engineer (Avionics). Two other occupations, Aircraft Maintenance Engineers (Airframe and Engine), are now only allowed short term visas and are ineligible for residency which will make them almost impossible to recruit from overseas. Without the ability to import these critical occupations, many smaller regional operators would not have survived up until now.

These tighter regulations that were enacted in April 2017 caused havoc on Australian airlines, with Qantas announcing a dozen permanent cancellations to their regional services due to a critical shortage of pilots. Most airlines, including Rex, have also experienced a doubling of cancellation rates in the past six months, for the same reason.

Rex is the only major airline in Australia that established its own pilot training academy simply to train new pilots for its airline. Despite almost eight years of effort and more than 20 completed intakes of cadet pilots, Rex is still obliged to recruit overseas as the rate of poaching, reflecting the shortage of pilots, by the larger carriers locally and abroad.

As a small regional carrier, Rex has been forced to conduct expensive recruitment exercises in South Africa, the United States and Europe to bring in experienced Captains. The removal of pilots and licensed engineers from the skills shortage list has been done without any aviation industry inputs besides the unions'. It is simply incredible that highly critical and scarce resources that require an enormous amount of specialised and high cost training were removed.

Whilst the Visa regulations implemented in April 2017 were somewhat relaxed in December 2017 to allow foreign pilots into Australia on two-year work visas, Rex does not believe that the two year work visa will be sufficient to attract experienced commercial pilots given the worldwide shortage facing the industry.

Rex does not believe that an experienced commercial pilot will be prepared to relocate themselves and their families to Australia, with the expectation of having to relocate again after only two years. Even with the possibility of a further two-year extension, the program will not be attractive given that Australian pilot salaries are not internationally competitive. Only the

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pathway towards Permanent Residency could be potentially attractive to those seeking a work-life balance, however, this pathway is closed under the current regulations.

6.3 STATE AND FEDERAL GOVERNMENT FUNDING OF NON ESSENTIAL AIRPORT EXPENDITURE

Rex has witnessed firsthand the irrational allocation of Government funding to regional airports by both State and Federal Governments. Rex supports rational airport upgrades that are commensurate to the needs of the regional community and there are many example of where Rex has provided local councils with letters of support to assist with such funding application.

However there are numerous examples where there has been a significant over allocation of funding for non essential airport expenditure. Rex would direct the committee to examine how much State and Federal Government funding has been allocated to regional airports, such as Dubbo (NSW), Orange (NSW) and Kangaroo Island to suggest a few.

Kanagaroo Island is in the final stages of a \$20M airport upgrade which has so far resulted in QantasLink mounting a less than daily service between Kangaroo Island and Adelaide (in competition to Rex's 3-4 daily services to Adelaide) and a limited trial service by QantasLink between Kangaroo Island and Melbourne, both of which could have occurred prior to the extensive airport upgrade being undertaken. The \$20M of funding is a significant taxpayer spend and there is no sound business case to support it. And in Mount Gambier, they are looking across the fence to Kangaroo Island and wanting to do the same based on a misguided view that Kangaroo Island airport upgrade is responsible for QantasLink bringing competition.

It is well and good for a regional airport to receive State or Federal Government funding for airport works however from Rex's experience it will result in the ongoing airport costs – depreciation, operating and maintenance costs - spiralling out of control.

The airport will inevitably pass these huge cost increases on to passengers. Fewer passengers will travel and in turn the remaining passengers will face even higher airport charges. This will cause a downward spiral in passenger numbers to a level where the regional air service could no longer be viable.

In the case of Kangaroo Island, depreciating an additional \$20M spend over 10 years would see additional depreciation costs of \$2M which equates to around \$40 per air ticket based on approximately 50,000 passengers per year. When it is realised that this far exceeds the airlines profit per ticket we can easily determine what will ultimately happen to the air service if the unrealistic assumptions in the funding application do come to fruition.

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7 IMPACTS THAT HIGH-COST REGIONAL AIRFARES HAVE ON REGIONAL CENTRES FROM A BUSINESS, TOURISM AND SOCIAL PERSPECTIVE

Regional air services linking remote and regional communities with Capital Cities are critical to the socio-economic wellbeing of Regional Australia. Regional air services are essential in the provision of business (including mining), government, medical and education related travel. Discretionary travel, including visiting friends and relatives is also very important for the social wellbeing of regional communities. As such regional communities will be severely affected if air travel is out of reach.

Rex believes that once air travel becomes unaffordable, the entire socio-economic fabric of the regional communities will enter into a terminal downward spiral. On the other hand, affordable fares will stimulate the economic activity of the regional cities as more industries will be attracted to set up their businesses there.

8 ACTIONS THAT THE STATE AND LOCAL GOVERNMENT AUTHORITIES CAN TAKE TO LIMIT INCREASES TO AIRFARES WITHOUT UNDERMINING THE COMMERCIAL VIABILITY OF RPT SERVICES

Rex believes there are several actions that the State and Local Government authorities can take to have a real and significant impact on lowering airfares.

8.1 LOCAL GOVERNMENT

Regional airports were vested to the local councils at no cost (often with a large sum to offset future maintenance costs) by the Federal Government prior to 1991. Regional airports are a vital piece of community infrastructure and form a valuable community asset.

In Rex's vast network of 58 airports, around 70% of the council owned regional airports are not able to recover the operating expenses from the airport charges. Most council's understand that charging a head tax rate to cover operating expenses would make the marginal air service completely not viable.

Local Councils should not consider the airport as a cash cow. Regional airports should be treated no differently than local roads and bridges as critical local infrastructure that has broad ranging benefits across the entire council municipalities. Yet, many regional airports adopt a user pays approach that requires the 'airport business' to stand-alone at no cost to the council ratepayer and in many cases generate a substantial surplus back to council.

Regional airports are dynamic with ever-changing passenger throughput and activity levels. In a competitive environment, regional airports should consider passenger and activity growth (and

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subsequent improved airport efficiencies) rather than simply applying routine increases of either CPI or greater.

Rex estimates that it costs about \$600,000-\$700,000 annually to effectively operate a regional airport, which includes having an adequate sinking fund to undertake significant airport works. From Rex's experience, the high cost of depreciation is often cited as the basis for needing much higher airport revenue. As outlined earlier, it is well and good for regional airports to receive State and Federal Government funding for airport investment however this increases the asset value of the airport which in turn causes airport depreciation costs to spiral out of control.

The concrete steps that the local councils can take to lower the cost of airfares are:

- Reduce airport charges / reduce the airport passenger tax. If this reduction is translated into lower ticket fares (through partnership agreements with the operators), there will be a stimulatory effect on the passenger numbers. More importantly it will create a positive impact on the socio-economic well being of the community. The net gain to the community far outweighs, in our opinion, the drop of airport revenue and local councils should get out of the myopic mindset and think of the bigger and longer term good of their community. Separate from the social advantages, the economic activity generated through a regional airport far exceeds any perceived short-falls in a regional airports financial position.
- Work in Partnership with the airline. Rex has pioneered and successfully implemented many innovative partnership programmes with various cities where both parties invest into growing the passenger numbers by reducing the airfares. .

8.2 STATE GOVERNMENT

State Governments have little control over the airport charges at either capital city or regional airports. However they can regulate more routes and then use this ability to select operators through the tender process such that it could achieve the following:

- Achieve the highest level of operational efficiency through higher load factors;
- Ensure that the efficiency gains are passed on to the passenger by ensuring the carrier only makes a fair economic return on the route. By so doing, the added efficiency would automatically translate into a lower ticket price;
- Ensure more frequencies as the passenger demand is stimulated by lower fares.

In WA, the awarding of the Perth Albany and Esperance routes to Rex through a competitive tender has clearly shown how such a model can work. From a money-losing venture for VARA, the route now has more frequencies, lower published fares including a great Community Fare

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Scheme, and a sustainable service since there is a sufficient fair economic return for Rex to want to continue servicing the routes.

This approach could and should be applied to other city suitable city pairs like Perth-Geraldton or Mount Isa to Townsville, Cairns or Brisbane for example. In the NSW network this could also apply to the higher volume routes such as Sydney to Albury, Armidale, Dubbo, Port Macquarie, Tamworth and Wagga Wagga.

A tender could be called to assess the commitments a carrier is prepared to make if given the right to be the sole operator - even on routes that already has competition.

This is already done by the Queensland Government who has regulated the Brisbane to Roma route that once had over 200,000 annual passengers.

On larger routes that have several operators, Rex would also like to see State Governments strictly enforce the best fare of the day (BFOD) travel policy for government related travel, in the absence of public servants being able to benefit personally from frequent flyer or loyalty reward programs, which inevitably skews travel on Qantas. This will ensure a level playing field for all carriers whilst also protecting taxpayers' money. The larger carriers have been able to charge significantly higher airfares to public servants travelling on government business due to the public servants being enticed by personal loyalty rewards. Without strict enforcement of the BFOD policy, public servants will always find ways to circumvent the BFOD policy to end up flying on a higher priced fare in return for personal benefit. This is a significant issue in Queensland that has contributed to Rex exiting the Mount Isa to Cairns route, in addition to the poor financial performance of the Cairns to Townsville route.

In addition to costing the State Government more, this practice has the nefarious effect of driving the small regional competitor out of business and without competition, the larger carriers are able to charge even more extortionist pricing. Without Governments strictly enforcing BFOD travel policies they are effectively contributing to the higher cost of air fares.

9 ACTIONS THAT AIRLINES CAN TAKE TO LIMIT INCREASES TO AIRFARES WITHOUT UNDERMINING COMMERCIAL VIABILITY OF RPT SERVICES

Rex has introduced a revolutionary Community Fare scheme on the Albany and Esperance routes in partnership with the City of Albany, the Shire of Esperance and Perth Airport. The Community Fare is priced at \$129 fully inclusive for both the Albany and Esperance routes and on an annual basis we have seen more than 8,000 community fares sold on each of the routes (in the first year of the scheme and this will no doubt increase in subsequent years) which equates to approximately 15% of total passengers and about \$1.2m savings for the community based on the average fare.

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The scheme has been so successful that all of the stakeholders have recently signed on for a 3-year extension of the scheme through until 30 June 2020. To achieve the \$129 fully inclusive price for the customer Rex has to lower its core fare to \$63 (Albany Perth) and \$73 (Esperance Perth) in order to accommodate the airport charges at Albany, Esperance and Perth. This is a significant investment undertaken by Rex to make fares more affordable and to stimulate passenger growth.

Rex has since extended this scheme in the communities of Broken Hill, Burnie, Moruya and Parkes. The continued roll-out of the Rex Community Fare Scheme across the Rex network demonstrates the initiative's success in providing regional and remote communities with more affordable air travel. Rex is willing to deliver such benefits to regional communities when the local councils take a longer term approach and are willing to create the necessary framework to make such initiatives possible to the longer term mutual benefit of the operator and the local community.

10 Conclusion

The Rex Group welcomes this opportunity to provide the Senate Standing Committee on Rural and Regional Affairs and Transport with this submission and further submission contact with Rex can be made via email: CompanySecretary@rex.com.au