

AIRPORT CAPACITY AND THE MODERN INFRASTRUCTURE CHANGES

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Introduction:

The developments in India have been quite remarkable. Privatisation has changed the face of airports and / or air travel in India.

Why privatise:

Two reasons: Airport infrastructure is capital intensive and associated with a long payback period. Moreover, the world over, international airports rely on over 50% of their revenues coming from non-aeronautical resources. The Government and the Government owned PSUs are ill-suited to harness this potential of the non-aeronautical revenues (such as hotels, passenger amenities, entertainment venues, retail etc).

All this led the Indian Government to embark upon privatisation and surely it is a move which could not have brooked any further delay. Before privatisation the Indian airports were bursting at their seams. For instance, the old airport at Delhi had a capacity to handle 12 million passengers per annum but it was handling over 20 million passengers per annum.

Some statistics:

In the last 10 years the airport traffic in India has increased by more than 4 times and in the next 8 years (by 2020) it is projected to increase by about another 3 times. Currently India is the 9th largest civil aviation market in the world and the projections are that in the next 15 years it will become the 3rd largest i.e. after USA and China. Therefore, it is witnessing explosive growth and there is no way the airport infrastructure would have met the expectations of the nation without privatisation.

The Story so far:

The privatisation story started in July 2004 when the concession agreement for the Bangalore airport was signed. Six months later, an identical agreement was signed for the Hyderabad airport. Both these were in the greenfield sector. Then came the two major airports in the brownfield sector i.e. New Delhi and Mumbai. These were awarded to the concessionaire in the year 2006 on an “as is where is basis”.

Airport privatisation started with a bang. Just these four airports between them account for over 60% of the market and therefore it made its presence felt so quickly. It was working!

The Delhi airport was completed on time; it has been adjudged the second best airport in the world by the Airports Council International in the category of 25-40 million passengers and in just about 5 years it has given a return of well over half a billion US\$ to the Government in revenue sharing (and this when the non - aeronautical side has not yet taken off). With this sort of a resounding success the pace of privatisation should have, if anything picked - on the contrary it stalled and after these 4 airports no airport was privatised till very recently. The chief reasons for this stalling were, first an absence of a detailed policy document. The greenfield / brownfield concession agreements signed by the Government in 2004 and 2006 seemed to suffer from anomalies and inconsistencies. There was a marked difference in the structuring and approach of the various airports. This difference was in terms of project monitoring, monitoring of the standards, imposition of liquidated damages etc. Just to give a flavour: in the greenfield airports of Bangalore & Hyderabad a delay as large as six months in project commissioning could be condoned on the ground that the Government had failed to perform its obligations. Thereafter the concessionaire got another six months in which period liquidated damages (LD) were a mere US\$ 2500 per day i.e. in six months it would amount to US\$ 4,50,000 - less than half million dollars in LD. As against that in the brownfield sector for the Delhi and Mumbai airports, even if there is a delay in submission of the Master Plan the LD would be US\$ 65,000 per day - mounting to US\$ 11.7 million within six months, after which the concession agreement could be cancelled. Indeed the brownfield operators ran the risk of LD (ultimately leading to termination of the contract) on at least 20 different counts most of which were not there in the greenfield airports. Hence there was a need to work out a consistent transparent mechanism and policy. The Government did this to a large extent in the year 2008 by announcing a Model

Concession Agreement for both the greenfield and brownfield sectors (its a unified policy on the subject).

The second reason for stalling was the absence of a Regulator. The four major airports privatised between 2004 and 2006 stipulated in the concession agreements that an independent Regulatory Authority would be set up in due course to approve charges, impose penalty, settle disputes between the Government and the concessionaire and balance the interest of the users (i.e. public) and the concessionaire. But for a long time this concept remained on paper. The Regulator was not constituted and the tasks envisaged for that body were being performed by the Ministry of Civil Aviation. This was of course only an ad hoc arrangement – neither independent nor transparent. An independent Regulator is essential to address the complexities in a long term PPP project such as airports and in its absence, it became difficult to attract investment, specially as the market was shifting to the smaller airports. Hence there was temporary stalling of India's privatisation efforts in these last few years. By February 2010 the Regulator and a judicial appellate authority to hear appeals therefrom were put in place by an Act of Parliament. Thereafter the momentum of privatisation seems to be picking up again.

Government has recently announced 14 new airports in the greenfield sector. A high powered Government Financial Task Force has concluded and recommended that the development and operations of virtually every significant in the country should be through PPP, whether they are in the greenfield or in the brownfield sector. The Government has realised that privatisation makes sense for a large number of reasons. They not only bring overall better airports but also help, generate larger revenues without imposition of high

user fees on passengers. Two major airports in India (Kolkata and Chennai) were not privatised. These are now loss making, despite a 6-7 times increase in the user charges and have now been recommended to be privatised.

Framework for privatisation:

I may now briefly discuss the salient features of the privatisation framework i.e. the Model Concession Agreement.

- (i) Philosophy / approach: The privatisation will be on DBFOT basis (Design, Build, Finance, Operate and Transfer). Only the core requirements will be spelt out by the State agencies leaving enough room for the concessionaire to innovate and add value. There will be no day to day interaction between the Government and the concessionaire. The Government will focus on the “What” rather than the “How”. The concession agreement will identify the key performance indicators and indicate the penalties for failure to achieve the prescribed level of performance.

- (ii) Section of a concessionaire: Selection of the concessionaire will be through an open competitive bidding process. The parameters will be described in the tender document with the concession period; user fees; technical parameters etc. all spelt out.

The financial bid will indicate the percentage of concession fee the concessionaire is willing to share with the Government. The bidder who offers the highest percentage of fee sharing will win the contract. To give an indication the bidder for the New Delhi airport offered and won the concession with a fee sharing offer of 46% of the gross revenue and the concessionaire for Mumbai airport won the bid for a fee sharing offer of 38.7%. Conversely, as there may be non-viable / remote airports, which need to be developed, the Government policy provides for grant of a subsidy from the Government in such cases. This is of course in exceptional cases where the airports may not be otherwise viable. In such a situation the bidder seeking the least subsidy from the Government would win the concession.

This Revenue Sharing model in India is I believe somewhat a distinct feature in airport privatisation.

- (iii) FDI Policy and Government holding: In theory, the Government allows up to 100% Foreign Direct Investment in the airport sector but in practice so far the governmental agencies have picked up 26% stake. It remains to be seen whether they will continue to do so for future airports also or allow 100% private equity. This

crucial 26% shareholding under our Companies Act ensures the Government's ability to veto certain "fundamental resolutions", (for instance issuance of shares, change of directors, change of auditors etc). This allows some degree of control by the Government and also furnish as an additional revenue stream for the Government - one through the revenue sharing model and the other through dividend income to the extent of its equity shareholding.

(iv) Concession period: This is of obvious and prime importance – the financial viability of the project is worked out on this basis. The concession period for airports in India is unusually long. It is 50 to 60 years. This longish period in recognition of the fact that in greenfield airports, the traffic build up may be gradual and further the investments in airport infrastructure as well as the non-aeronautical side takes a long period to recover.

(v) Financial viability: Financial viability of the project rests on the non-aeronautical services and more specifically a chunk of 5% of the total airport land leased to the concessionaire for free commercial exploitation and development. Considering the acute scarcity and high price of real estate in Indian cities, this is the commercial backbone of

the project. To give an idea, the concessionaire for Bangalore airport got about 300 acres of land and the concessionaire for New Delhi got 230 prime acres for free commercial development. As the concessionaire has only a leasehold right on the airport land, it can only grant sub-licenses for the real estate development and the land would revert to the Government at the end of the concession period. This is perhaps why the concession period for airports is as large as 60 years as against 15 to 30 years for roads, ports etc.

(vi) Risk allocation:

The basic mantra and the underlying principle here is that the risk will be allocated to the party best suited to manage it. Hence all commercial and technical risks relating to the construction, operation and maintenance are allotted to the concessionaire. The commercial risks are partly cushioned. As economic growth of a country can be unpredictable (especially if you are looking at a 60 year period), the Model Concession Agreement provides for extension of the concession period in the event of a lower than expected growth in the traffic. This is subject to a 20% ceiling i.e. the concession period can be extended by up to 20% if the passenger traffic is adversely affected beyond the specified ranges and conversely it

can be reduced if the traffic is higher than predicted.

Political risks including “change of law” risk is assigned to the Government. The Government will compensate the concessionaire for any loss arising out of change in law if the loss exceeds the Rupee equivalent of about 2 million dollars aggregate in any given year. This will be through amendment to the concession agreement (but it is not indicated anywhere in which manner the agreement will be amended – it can perhaps only be by extension of the concession period). It is stated that if there is no amendment within 90 days, the Government of India will compensate the concessionaire in cash to the extent of the loss.

State support and comfort:

One noteworthy feature of risk allocation is that the Government undertakes to support the project. For instance, a concession agreement states, “GOI acknowledges and supports the implementation of project”. It further states that the Government of India will not take any steps or action in contradiction with the concession agreement which results in or would result in its shareholders or the lenders being deprived or substantially deprived of their investment or economic interest in the project. Further all statutory and non-statutory bodies under the control of the Central Government will act in compliance with the concession agreement as if they are a party thereto and the Government of India shall ensure that all statutory compliances as may be required are granted promptly. The State Governments will similarly enter into State Support Agreements.

This is a unique feature in airport privatization in India. The Port sector or Road sector do not have similar commitments from the Government.

This in brief is a snapshot of the framework for privatisation.

Regulatory mechanism:

I may now briefly describe the regulatory mechanism put in place. As well recognised, an independent regulator plays a key role in encouraging private investment in long term infrastructure projects and is crucial to make the project bankable. The Government took a while in putting together the regulatory mechanism in relation to airports chiefly because the exercise was preceded by an in depth study on the philosophy and approach on the regulation of infrastructure. Parliament passed the necessary statute in this regard in December 2008. The Act came into force in September 2009 and by the time the appointments were made it was February 2010. The statute constitutes the Regulator and an Appellate Tribunal to hear appeals therefrom. The Regulator will be for all major airports (Government as well as private). A “major airport” is defined as one having an annual traffic of 1.5 million passengers or more per annum and notified by the Government as such. Currently there are thirteen major airports in the country (and they all now fall within the purview of the Regulator).

The Regulator has basically two functions: (i) to regulate tariff and other charges for aeronautical services and (ii) to monitor performance standards for airports. The Act mandates the Regulator to ensure transparency in discharge of its functions. This is to be

achieved essentially through consultations with all stakeholders. Full reports and regulations are required to be periodically tabled before Parliament.

The judicial forum would have jurisdiction not only in relation to appeals from the decision of the Regulator but also to decide disputes between two or more service providers or between a service provider and a consumer group. The judicial tribunal is to be headed by a former Supreme Court Judge or a former Chief Justice of a High Court.

Road ahead:

Despite a well thought out and sincere commitment on the part of Government of India to put in place an efficient mechanism for privatisation, it would seem that the road ahead is not without bumps. It would seem that the various constitutional authorities have not yet fully ironed out their differences in approach and these surface every now and then. A recent report of the Comptroller & Auditor General (CAG) of India is an illustrative. The CAG is a Constitutional body and its reports are required to be tabled before Parliament and obviously any adverse report is used to beat down the Government and accuse it of wrongdoing etc. Recently the CAG carried out an in-depth audit exercise for the New Delhi airport and published its report on 11th May 2012. In brief, the CAG has faulted the Government's privatisation for over 1 dozen so called irregularities. The CAG questions why the concession period has been made as long as 60 years and says that no exercise was done to correlate this period with the capital costs and recovery expected. It says the concession period should have been linked with the expected traffic, the tariff and the capital costs involved. The CAG has also objected to the ROFR Clause which says that if another airport is to come

up within a period of 30 years and within the radius of 150 kms then the concessionaire will have a right of first refusal. In the event the concessionaire is unsuccessful in its bid it will be allowed an opportunity to match the most competitive bid provided its bid is within 10% of the most competitive bid. The CAG has found this to be unfair and thwarts competition. Indeed the CAG goes to the root of the matter by questioning why 5% of the land was given to the concessionaire “free of costs” for commercial exploitation. Now this questions the very basis on which privatisation is structured. It simply ignores all that has happened in the highest level of Government and comes from a space as if it is working on a clean slate. Now that the CAG has raised these basic questions, will the Government still push ahead with its policy or will we sadly see airport privatisation on the back burner once again. Even if the Government pushes ahead one can only imagine the deterrent effect it would have on future investors in this sector.

I would conclude by saying that we are too far gone to put the clock back on privatisation and I do expect the thrust in the airport sector to continue. At the same time we need to recognise that there may be hindrances along the path.