Bangalore International Airport Limited
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CIN: U45203KA2001PLC028418

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Dated: 11th June 2018

Ref: AERA/Finance/2018-19/04

To
The Secretary,
Airports Economic Regulatory Authority of India
AERA Building, Administrative Complex,
Safdarjung Airport, New Delhi -110 003.

Subject: BIAL response to Consultation Paper no.04/2018-19
Ref: CP no.04/2018-19 dated 8th May 2018 in the matter of determination of Fair Rate of Return (FRoR) to be provided on Cost of Land incurred by various Airport Operators of India

Dear Madam,

In reference to the above Consultation paper, we thank the Authority for giving the opportunity to stakeholders to give comments and suggestions on the proposed position taken by AERA in each matter.

Please find herewith BIAL's response on the specific points for kind consideration at your end.

Thanking You.
Yours faithfully,

For Bangalore International Airport Limited

Bhaskar Anand Rao
Chief Financial Officer

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Background:

In certain airports, Government acquires land which is provided to the airport through transfer in value against equity eg, in Cochin, Chandigarh, Kannur. Currently this land is not forming part of RAB and no returns are being given. The AERA intends to provide a return for cost of land.

Recovering the Costs of Land for airport operators

Airport projects like most infrastructure projects span across a long term time horizon; and accordingly investments in airport assets (including those in airport land) are locked-in till the airport continues operations. Investments in land used to provide aeronautical services cannot be recovered by the airport operator, unless such costs are factored in airport tariffs. Rentals (if any) received from such land used for aeronautical services would be considered as a recovery towards the ARR of the airport operator and any capital appreciation on such land will never be realized until the airport ceases operations. As regulated airport operators do not have any avenues to recover their investments in land used for aeronautical services, BIAL appreciates this opportunity of discussing on how airport operators who have already incurred an expense on airport land can be allowed to recover their investments and expresses its agreement with the Authority stand that *"Refusal to provide such a return could disincentivize acquisition of land which is a primary requirement for airport development."*

However, we note that the Authority has also stated that *"In public interest, the return on cost of land should be such that its impact on tariff is minimum."* We would request the Authority to revisit this stated position based on the following submissions. AERA's Guidelines on regulation of airports, Terms and Conditions for Determination of Tariff for Airport Operators Guidelines, 2011 ("Airport Guidelines") mentions that *"In normal course, all airport fixed assets will come under the scope of the RAB."* Further the Direction explicitly mentions certain principles based on which fixed assets can be included / excluded from the scope of RAB. The exclusion of land from the RAB boundary which is a bona fide investment made by the airport operator merely on the grounds that it is in public interest to ensure that that its *"impact on tariff is minimum"* would be unjustified. The economic regulation should aim to strike a balance between public interest and interest of airport operator and other stakeholders.

Also, Section 13a of the AERA Act mandates the Authority to determine tariffs for aeronautical services considering *"the capital expenditure incurred and timely investment in improvement of airport facilities"* and ensuring *"economic and viable operation of major airports"*. On that account, AERA must provide a fair rate of return on the bona fide capital expenditure incurred by an airport operator to establish airport infrastructure, by including such investments into the airport's Regulatory Asset Base.

Comments on AERA's proposed methodologies for recovering the cost of land

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The Authority vide its Consultation Paper 04/2018-19 has proposed two alternatives for recovering the cost of land. Extracts from the Consultation Paper summarizing the alternatives are presented below,

"4.4.1.b. Scenario 1: Providing a FRoR on the Cost of Land incurred. The land cost does not flow into the RAB since land is a non-depreciable asset. Therefore, the return is provided at the historical cost for a period equivalent to the concession agreement, or until the cost of land is recovered by the acquirer, whichever occurs first.

4.4.1.c. Scenario 2: Amortizing the historical land cost at a fixed rate of 3% per annum until the time the cost of land is realized. This amortization will be treated as an expense notionally and recorded under the Operational Expenses of the concerned Airport Operator."

Further, the Authority has computed the impact on tariffs under the above alternatives and presented the results of the same in the form of a scenario analysis which is presented below,

Airport	Percentage increase in tariff in case of FRoR provided on land cost	Percentage increase in tariff increase in case of amortization of cost of land
Cochin	2.86%	1.13%
Chandigarh	62.09%	13.30%
Kannur	13.91%	2.51%

While the Consultation Paper adequately captures the impact of the proposed alternatives on tariffs at the respective airports, it remains silent on their impact on the financial position of airport operators. Based on the assumptions used in the two approaches proposed by the Authority, we have computed the aggregate recoveries from land for the airport operator in present value terms; and the corresponding revenue deficits suffered by the respective airports. The following table presents the results of our analysis,

Table 1: Analysing the financial position of the airport operator under Scenario 1

Scenario 1 (all figures in crores)	Actual cost	NPV of aggregate land recoveries*	Financial Loss Suffered by the Airport
Cochin Airport	₹ 109.32	₹ 66.93	₹ 42.39
Chandigarh Airport	₹ 450.00	₹ 273.32	₹ 176.68
Kannur Airport	₹ 315.93	₹ 192.12	₹ 123.81
*NPV of aggregate land recoveries was computed based on the FRoRs of the airports i.e. 11.2%, 14% and 13.33% respectively			

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Table 2: Analysing the financial position of the airport operator under Scenario 2

Scenario 2** (all figures in crores)	Actual cost	NPV of aggregate land recoveries*	Financial Loss Suffered by the Airport
Cochin Airport	₹ 109.32	₹ 28.43	₹ 80.89
Chandigarh Airport	₹ 450.00	₹ 95.20	₹ 354.80
Kannur Airport	₹ 315.93	₹ 70.00	₹ 245.93
* NPV of aggregate land recoveries was computed based on the FRoRs of the airports i.e. 11.2%, 14% and 13.33% respectively ** The scenario does not make any assumptions on the concession period and assumes a return on land till the aggregate recoveries equals the historical cost of the asset			

Based on the above analysis, it is evident that under both these approaches, the airport operator suffers a financial loss amounting to a significant portion of his aggregate investment in airport land. Financial losses in proportion to the actual investment in land suffered by the airport operator in the above scenarios are presented below:

Table 3: Estimating the extent of under recoveries under the Authority's alternatives

Particulars	Scenario 1	Scenario 2
Cochin Airport	38.8%	74.0%
Chandigarh Airport	39.3%	78.8%
Kannur Airport	39.2%	77.8%

Considering the magnitude, it would be appropriate to highlight that such under recoveries / losses may threaten the viability of an airport project. An appropriate solution would be to include the cost of aeronautical portion of airport land into the RAB of the airport operator; thereby allowing a fair rate of return on the same. Such a treatment by the Authority would also be consistent with the Airport Guidelines.

Further, if the Authority believes that the *"the return on cost of land should be such that its impact on tariff is minimum"*, the cost of such airport lands (especially the lands used for aeronautical purposes) should be borne by State Government(s); which stand to benefit the most from the ripple effects of the airport projects. A justification for the same is presented in the section below.

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Benefits of airports and civil aviation for the State Governments

The civil aviation sector is a key driver of the regional economy, and closely linked to region's economic growth and development. It has a direct impact on the economy by contributing to the national income / generating direct employment as well as an indirect effect on other industries throughout the economy (e.g. travel and tourism, real estate etc.) in the form of an economic multiplier. As per a report published by ICAO[1] *"In the global economy, every $100 of output produced and every 100 jobs generated by air transport trigger additional demand of some $325 and 610 jobs in other industries."* Hence, we can infer that progressive state governments cannot afford to miss the catalytic and induced effects of developing civil aviation in their region. As a result, State Governments in India, have on multiple instances allocated land for the development of airport projects at nominal charges, i.e. without seeking any monetary consideration.

Further, even when State Governments acquire land for airport projects; they are cognizant of the fact that the expenses incurred to acquire such airport land are inconsequential compared to the economic benefits of an airport project in the longer term.

Further, given the current state of technological advancements, there appears to be no proxy / substitute to civil aviation. Hence, the argument from the State Government that *"in case no return are given on the cost of the land acquired, it might be beneficial for the State Government to spend the fund on development of other infrastructure which will immediately benefit the Government and local population"* must be re-examined by the AERA for its merit.

Further, BIAl wishes to submit that in case the Authority believes that the *"the return on cost of land should be such that its impact on tariff is minimum"*, the cost of such airport lands (especially the lands used for aeronautical purposes) should be borne by State Government(s) so as to not have any adverse impact for the airport operator.

[1] Economic Contribution of Civil Aviation, Ripples of prosperity