

NABH Nirman 2018

Proposed transaction structure for Greenfield airports

Detailed note

Background

1. India is one of the fastest growing aviation markets in the world. Traffic growth in the last three years has been in the range of 16-18 percent per annum. India is expected to be the third largest aviation market in 2020 behind USA and China.
2. One key challenge being faced by airlines is on the airport infrastructure front. India needs significant investment in airports – in funding, construction and operations. This will require participation by leading corporate groups from India and abroad.
3. The Hon'ble Finance Minister of India, Mr. Arun Jaitley in his FY 2018-19 Budget speech proposed to “expand our airport capacity more than five times to handle a billion trips a year under a new initiative: NABH Nirman”.¹
4. The major challenges faced by the Indian airport sector include: lumpiness of investments, tariff uncertainty, low interest by foreign and domestic investors, lengthy legal disputes, long bidding process, challenges in fund-raising, revenue leakage risk in PPP airports and sub-optimal exploitation of real estate.
5. To address the challenges, the Ministry of Civil Aviation (MoCA), Government of India is proposing a new transaction structure for future greenfield airports under NABH Nirman 2018.

Principles of the proposed transaction structure

6. The guiding principles of the proposed transaction structure are:
 - a) Affordability
 - b) Sustainability and
 - c) Predictability.
7. The strength of India's aviation market is its 400 million strong middle class people. Even if they fly just once a year, we are looking at 800 million domestic trips. The 122 million domestic trips that India recorded in FY 17-18 is barely scratching the surface.
8. Given that the Indian middle class is extremely price-sensitive market, any model we come up with had to meet the **affordability** test. It is for this reason that the government is proposing a reasonable cap on the aeronautical yield per passenger.
9. Investors look for a predictable tariff regime. The aviation sector is affected by various extraneous factors like crude oil prices, exchange rates, geopolitics, health epidemics and even a volcanic eruption in faraway Iceland.

¹NABH: NextGen Airports for Bharat; Nirman: Development

10. The huge fluctuation in the aeronautical yield under the 'cost-plus model' makes investors, lenders and airlines jittery. So does the intrusive monitoring of capex, non-aeronautical revenue, operating cost and cost of capital etc.; delays in tariff fixation and frequent legal disputes. The pre-determined aeronautical yield will provide significant **predictability** to the tariff regime for the entire Concession Period.
11. Pre-determined aeronautical yields also ensure long term **sustainability** of all stakeholders. The proposed yield has been arrived at on the basis of projected cash flow analysis for greenfield airports of different capacities and a review of aeronautical yields at Indian and global airports in the recent past. This will ensure adequate returns to the investors while also keeping airport charges reasonable for airlines and passengers.
12. Concessionaires will have significant freedom to earn high returns from non-aeronautical sources through innovative offerings. This is one of the biggest advantages to Concessionaires in the proposed model, other than the reduced cost of disputes and litigation.

Key features of the proposed transaction structure

Scope of the concession

13. The concession shall be on a 'Develop, build, finance, operate and transfer' (DBFOT) basis.

Concession Period

14. Different options for the Concession Period has been analysed on the basis of projected income, expenses, capital expenditure, expected returns on investment, global benchmarks and the range of acceptable tariffs.
15. A long Concession Period gives investors greater possibility to recover capital investments and to address traffic fluctuations. A short Concession Period may lead to high tariffs.
16. Based on the analysis and preliminary stakeholder consultations, it is proposed to offer a Concession Period of 40 years for greenfield airports.

Bid parameter

17. In India, 'share of gross revenue' of the airport operator has been the bid parameter in greenfield airport projects so far. There are many challenges, however, in monitoring and finalising the 'gross revenue' and hence the share thereof payable to the Concessions Authority. The intrusive accounting process, controversies and legal disputes lead to wastage of time, effort and money for all parties involved with limited positive outcome. The government has therefore decided to shift to a simple, transparent bid parameter which has near-zero risk of revenue leakage.

18. After careful analysis of various options, the bid parameter is proposed to be the 'Concession Fee' payable to the Concessioneing Authority in terms of INR per passenger.
19. In addition, the Concessionaire shall also pay an 'Administrative Fee' to the Authority. The Administrative Fee for FY 18-19 is proposed to be INR 20 per passenger.
20. The annual change in fee (Concession Fee plus Administrative Fee) is proposed to be indexed to 50% of inflation in the previous year. The inflation shall be calculated as the weighted average of variation in Wholesale Price Index (WPI) and Consumer Price Index for Industrial Workers (CPI-IW) in 70:30 ratio.
21. For instance in a given year if the change in WPI and CPI (IW) is 5% and 7% respectively, the fee for next year shall increase by 2.8%. The calculation is as follows:
$$\text{Weighted average inflation} = 0.7 \times 5\% + 0.3 \times 7\% = 5.6\%$$
$$\text{Increase in fee} = 0.5 \times 5.6\% = 2.8\%.$$

Concession Fee moratorium

22. Greenfield airports require large capital expenditure and the traffic buildup takes time. A moratorium on the Concession Fee is proposed for a period of three years from the Commercial Operation Date (COD) of the airport.
23. The Concessionaire shall however pay the Administrative Fee to the Concessioneing Authority from the COD onwards.

Tariff structure

24. The current cost-plus tariff structure involves a long-drawn tariff determination process every five years and then adjustments on an annual basis. There are elements of subjectivity and regular disputes on quantum of aeronautical and non-aeronautical revenue, operating expenses, regulatory asset base, cost of capital etc. Many decisions of the Regulator are legally challenged by airport operators.
25. The wide variation in the airport tariffs creates challenges for domestic and foreign airlines who have to recover the same from passengers. It runs counter to the stated objectives of affordability, sustainability and predictability. Many domestic and global investors and lenders have highlighted this as one of the key reasons why they have stayed away from investing in India, despite it being the fastest growing aviation market in the world.
26. The government plans to correct this anomaly. It is therefore proposed to shift to a pre-determined tariff structure.
27. The 'Maximum Blended Aeronautical Yield' (MBAY) in terms of INR per passenger shall be pre-determined by the Concessioneing Authority at the beginning of the Concession Period. It

- shall undergo only minor adjustments to account for certain eventualities, explained later in this document.
28. The MBAY for greenfield airports for the year FY 18-19 is proposed to be INR 400 per passenger. The number has been arrived at on the basis of cash flow projections for greenfield airports of different capacities and review of aeronautical yields at Indian airports in the recent past.
 29. The total annual allowable aeronautical revenue for the Concessionaire shall be the MBAY multiplied by the annual number of passengers at that airport.
 30. Bidders for a particular greenfield airport will carry out their traffic and financial projections considering this tariff structure and propose a Concession Fee. The bidder quoting the highest Concession Fee will be declared the highest ranked bidder. Since the traffic and financial profile of each greenfield airport will differ from the other, so will the corresponding Concession Fee.
 31. There is a possibility that at certain airports, bidders may feel that the proposed MBAY is not adequate to cover their expenses and business risks. Bidders may be allowed to quote a 'Negative Concession Fee'.
 32. If no bidder quotes a zero or positive number as Concession Fee at an airport, the bidder with the lowest Negative Concession Fee shall be declared as the highest ranked bidder. The lowest Negative Concession Fee shall then be added back to the proposed MBAY to arrive at the actual MBAY for that year. There would be no Concession Fee at such an airport and the winning bidder will only pay the Administrative Fee to the Concessioneing Authority every month. This approach has been illustrated in the next paragraph.
 33. For instance, if a greenfield airport bid receives no positive or zero Concession Fee and the Negative Concession Fee quotes are -45, -60 and -75 INR per passenger, the bidder quoting -45 INR per passenger will be declared as the highest ranked bidder. In such a case the MBAY for that airport for FY 18-19 shall be INR 445 per passenger ($400 + 45 = 445$). The Concessionaire in this case shall only pay the Administrative Fee to the Authority (INR 20 per passenger for FY 18-19) and no Concession Fee.
 34. Once every five years, the Concessionaire shall submit its proposed tariff card and projected traffic for the five year period to the Regulator. The tariff card shall be developed in such a way that the projected aeronautical yield during the five year period is less than or equal to the MBAY on a present value basis. The Regulator may approve the same after due scrutiny and public consultation.
 35. In case the actual aeronautical yield in a year is lower than the MBAY, this may be due to fall in traffic (traffic variance) or due to price discounts (price variance). The shortfall in aeronautical yield due to traffic variance may be adjusted by way of higher MBAY in subsequent years. The

shortfall due to price discounts to individual airlines or stakeholders shall be absorbed by the Concessionaire.

36. At the end of each year Concessionaire shall submit audited traffic and financial statements. At the end of every five years, the Regulator shall review the audit reports and approve the tariff card for the subsequent five years. The base rate of MBAY for the next five years may be adjusted based on actual aeronautical yield of the Concessionaire in the previous five year period.
37. In line with the Concession Fee and Administrative Fee, the base rate of MBAY is proposed to be indexed to 50% of inflation. The balance cost of inflation is expected to be adequately compensated by way of traffic growth, operational efficiency and increase in non-aeronautical revenue. Inflation will be calculated as the weighted average of the variation in WPI and CPI-IW in 70:30 ratio, as mentioned earlier.
38. Assuming the annual increase in MBAY to be around 2-3% per annum, the value of MBAY is projected to be as follows:

Year	MBAY (INR per passenger)	
	Increase @ 2% pa	Increase @ 3% pa
1	400	400
10	478	522
20	583	701
30	710	943
40	866	1267

39. MBAY is a blended yield of domestic and international traffic. Aeronautical yields from international passengers are generally higher than that of domestic passengers since the infrastructure, capex and operating costs associated with international passengers are higher. The aeronautical yield from domestic passengers would therefore be proportionately lower than the proposed MBAY of INR 400 per passenger in FY 18-19.

What comprises MBAY?

40. MBAY shall cover revenues accruing to the Concessionaire from all services that are critical for aviation activities and where the Concessionaire exercises significant market power.
41. The revenue items of the Concessionaire that shall form part of MBAY include:
- a) Landing, housing and parking charges levied on all aircraft
 - b) Revenue of Concessionaire from cargo, ground handling agencies, aircraft fueling, inflight catering, aerobridge charges, Common-Use Terminal Equipment (CUTE), Common-Use Self-Service (CUSS), Baggage Reconciliation System(BRS) etc.
 - c) Passenger service fee – facilitation component (PSF-FC).

- d) Normative interest on security deposit from aeronautical stakeholders (RBI bank Rate plus 3% per annum), and
 - e) Revenue from any new aeronautical service offered with the approval from the Regulator.
42. The revenue items of the Concessionaire that are proposed to be regulated by the Regulator but kept outside the ambit of the MBAY include:
- a) Rental income from airlines and government entities like Customs, Immigration etc. The minimum area to be provided to such entities will be stipulated by the Regulator.
 - b) Revenue to Concessionaire from Maintenance, Repair and Overhaul (MRO) service providers
 - c) Revenue to Concessionaire from General Aviation service providers
 - d) Passenger service fee – security component (PSF-SC),
 - e) Passenger and staff entry charges
 - f) Vehicle entry and parking charges
 - g) Revenue from any other service as may be stipulated by the Regulator
43. Revenue items of the Concessionaire that may be free from price-regulation include:
- a) Revenue from restaurants, retail outlets, duty-free shops etc.,
 - b) Revenue from real estate activities outside aeronautical area (hotels, malls etc.), and
 - c) Advertisement revenue.
44. If a Concessionaire is found understating the aeronautical revenue from any source, through misrepresentation of facts and/or collusion with other entities, the same shall be treated as severe violation of the Concession Agreement. It shall lead to termination of the Concession Agreement and penal action as per law.

Outsourcing of activities under MBAY

45. Certain aeronautical activities covered under MBAY like cargo handling, ground handling agencies, aircraft fueling, inflight catering, aerobridge handling, CUTE, CUSS, BRS etc. can be outsourced to third parties on an arms-length basis through a transparent global bidding process.
46. The third-parties so selected shall not have a common shareholding, direct or indirect, of more than 20% with the Concessionaire.
47. Under no circumstances will activities covered under ‘Landing, housing and parking charges on all aircraft’ be outsourced. Should it is allowed, on an exceptional basis, the revenue of the third party agency in respect of these services shall be treated as the revenue of the Concessionaire for calculating the MBAY.
48. Concessionaires shall ensure that there are at least two third-party cargo handling agencies at the airport. Further details shall be provided in the National Cargo Policy 2018 which is currently under development.

49. The Regulator may decide to regulate user-charges of some or all third-party services like cargo handling, ground handling agencies, aircraft fueling, inflight catering, aerobridge handling, CUTE, CUSS, BRS, General Aviation terminal etc. as it may deem appropriate.

Service quality framework

50. Under the pre-determined yield approach, the monitoring of quality of infrastructure and service shall be of paramount interest.
51. The Regulator may formulate the Key Performance Indicators (KPI) for greenfield airports. The Regulator may review and modify the KPI once every five years.
52. The KPIs shall be as objective and transparent as possible. The measurement of KPIs shall be technology-driven, to the extent possible, so as to minimise the risk of human interventions and disputes.
53. The Regulator may create a panel of Service Quality Auditors (SQA). The Concessioneing Authority shall appoint an empanelled SQA to monitor and certify compliance with the KPIs.
54. The Concession Agreement shall require strict compliance with the KPIs.
55. The Concessionaire needs to ensure that development of infrastructure happens ahead of demand. The Concessionaire shall be required to undertake capital expansion as and when required, subject to the condition that at no point in time, the capacity utilization of airside, terminal or city-side infrastructure touches X% of the peak hour capacity for more than Y hours per day. **We welcome stakeholder feedback on what the proposed values of X and Y should be.**
56. Every greenfield airport shall form an Airport User Consultative Committee (AUCC) to monitor the Concessionaire's overall performance.
57. The Chairman of the AUCC shall be the Secretary, Civil Aviation of the State (or equivalent). The AUCC shall comprise representatives of Concessioneing Authority, MoCA, DGCA, AAI, airlines, sub-concessionaires and passenger groups. The AUCC may meet at least once every three months and review the SQA's reports. The AUCC may hold emergency meetings at short notice with the concurrence of the AUCC Chairman, should a situation so demand.
58. AUCC shall have the powers to issue written warnings to the Concessionaire on non-compliance with KPIs and advise a reasonable cure-period to resolve the same. Should the issue remain unresolved, the AUCC may recommend, to the Regulator, a financial penalty to be imposed on the Concessionaire. The penalty shall be limited to 10% of the prevailing MBAY in each instance, for a period not exceeding 12 months.
59. Cumulative financial penalty of 25% on the Concessionaire due to violation of KPIs may lead to termination of the Concession Agreement.

60. The AUCC shall have the discretion to recommend to the Regulator an increase of 10% in MBAY for a period not exceeding one year in case the Concessionaire exceeds the KPIs on a consistent basis.
61. The power to approve a penalty or reward in terms of change in MBAY shall rest with the Regulator.

Land for non-aeronautical real estate development

62. Given that airport development requires lumpy capital investment with a long payback period, use of airport land for real estate development assumes additional importance. It helps the Concessionaire generate additional funds that can be used for airport development and for cross-subsidizing its operational expenses. It also helps the airport become a self-contained eco-system for growth with hotels, commercial complexes, restaurants, entertainment hubs and convention centres in close proximity of the airport. At the same time, care has to be taken that the real estate component does not become more important for the Concessionaire than core airport development and operations.
63. It is proposed that the non-aeronautical real-estate development area be limited to 10% of airport area. The nature of usage of the real estate area (industrial, commercial, residential etc.) may be made unrestricted, as per prevailing law.
64. In order to provide greater comfort to real estate developers on airport land, it is proposed that the duration of the lease agreement may be for 99 years from the date of commencement of the Concession Period. In the past such agreements have been co-terminus with the Concession Period.
65. The lease agreement may be a bipartite agreement between Concessionaire and lessee if the lease period does not extend beyond the Concession Period. If the lease period extends beyond the Concession Period, the lease agreement may be a tripartite agreement between the Authority, Concessionaire and the lessee.
66. The Concessionaire and the real estate entity shall be free to undergo change of ownership structure during the lease period, subject to equity lock-in period for Concessionaire's shareholders, as may be specified. At the end of the Concession Period, the Concessionaire shall exit the tripartite agreement. The Authority may then become the receiver of future lease payments or may decide to pass it on to the new Concessionaire, as it may deem fit.
67. As regards the passenger terminal building, there shall be no limit on the non-aeronautical commercial area, subject to the KPIs on passenger seating area, passenger facilities, safety and security.

Financial support to Concessionaire

68. Under the proposed approach, the traffic risk, capex risk and operational risks lie with the Concessionaire. There is a possibility that the Concessionaire may face financial challenges during the course of the Concession Period.
69. In such cases, the Concessionaire shall have the option of seeking financial support from the Concessions Authority on a recoverable basis. The support period shall be limited to a sum total of five years during the first 30 years of the Concession Period. The five years may be in continuity or in blocks of years. Each block shall be multiple of one year, e.g., 1, 2, 3 or 4 years.
70. During the financial support period, the Concessionaire shall be allowed by the Concessions Authority not to pay the Concession Fee, in part or full. Should that not be adequate, the Concessionaire may approach the Regulator for levying a higher aeronautical yield per passenger, limited to 50% of the prevailing MBAY.
71. The amount received by Concessionaire as financial support shall be paid back by the Concessionaire to the Concessions Authority and passengers at the rate of RBI Bank Rate plus 3% per annum. The payback shall be in the form of higher Concession Fee to Authority and/or lower MBAY, as the case may be. The exact duration of payback shall be agreed between the Concessionaire, Concessions Authority and the Regulator.

Capex towards the end of Concession Period

72. There is a perception that under the pre-determined yield model, the Concessionaire may not be keen to invest in infrastructure during the closing stages of the Concession Period.
73. It is proposed that by the end of the 30th year of the concession period, the Concessions Authority and Concessionaire shall agree the list and timelines of 'Mandatory Capital Projects' (MCP) to be undertaken till the end of the Concession Period. This shall be in consultation with AUCC and subject to approval from the Regulator.
74. In case the remaining part of the Concession Period is not adequate to recover the capex, the Regulator may consider allowing the Concessionaire to levy an additional yield (limited to 50% of the prevailing MBAY) and/ or recommend increasing the Concession Period to the Concessions Authority (limited to 10% of the original Concession Period).
75. In case the Concessionaire is not able to recover the capex till the end of the Concession Period, the Concessions Authority may decide to compensate the Concessionaire by paying an amount equivalent to 80% of the Adjusted Depreciated Asset Value. The adjustment shall be for the amount collected by way of additional yield and/or additional Concession Period.
76. The compensation may be paid by Concessions Authority to Concessionaire on a lump-sum basis or on an installment basis in present value terms. The compensation amount may be

recovered by the Concessioneing Authority from the next Concessionaire on a lump-sum or installment basis.

77. Non-compliance or non-agreement with the MCP by Concessionaire may lead to penal action by Concessioneing Authority as laid down in the Concession Agreement.

Equity stake of Concessioneing Authority

78. It is proposed that that Concessioneing Authority may have no equity stake in the Concessionaire. However, all reserve matters shall be laid down in the Concession Agreement and shall require the Concessioneing Authority's approval. The reserve matters shall be kept to a minimum to avoid undue interference in day to day airport operations.
79. This approach provides the Concessioneing Authority adequate power to monitor and control the performance of the Concessionaire. It prevents the need for the Authority to contribute funds in proportion to its equity stake in the Concessionaire. It also allows greater freedom to the Concessionaire to bring in additional share-holders for the 26% equity that traditionally used to be held by government entities.

Change of Scope

80. 'Change of Scope' by the Concessioneing Authority is proposed to be limited to unforeseen transport connectivity projects(e.g. road, rail, metro, waterways etc.) that may not have been envisaged in the original master plan.
81. To recover the investment, Authority may provide waiver of concession fee, followed by, if required, increase in yield limited to 50% of blended yield (subject to approval of the Regulator) or increase in concession period by a maximum of 10%.

Maximum increase in MBAY

82. At no point during the Concession Period, the increase in MBAY for various interventions such as revenue shortfall loan, traffic variance, service quality incentives or change in scope etc. shall exceed 50% of the base rate of MBAY for that year.

Equity lock-in for Concessionaire

83. The minimum shareholding of the lead member in the Concessionaire shall be 51%.
84. The minimum shareholding of the designated airport operator, in case lead member does not possess airport operations experience, shall be 10%.
85. All equity members of a Concessionaire whose technical and financial capacity has been considered for assessing the Consortium's eligibility shall have an equity lock-in period of five years from COD. Thereafter, they shall be free to exit completely.