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**Supplementary Consultation Paper No. 17/ 2018-19**

सत्यमेव जयते

**Airports Economic Regulatory Authority of India**

# In the matter of Determination of Fair Rate of Return (FRoR) to be provided on Cost of Land incurred by various Airport Operators in India.

**(in continuation to Consultation Paper No. 04/2018-19 dated 08.05.2018)**

**01st October, 2018**

**AERA Building**
**Administrative Complex**
**Safdarjung Airport**
**New Delhi – 110 003**

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## 1. LIST OF ABBREVIATIONS

| | |
|---|---|
| **AAI** | Airport Authority of India |
| **AERA Act** | Airports Economic Regulatory Authority Act, 2008 |
| **AERA or the Authority** | Airports Economic Regulatory Authority |
| **BAOA** | Business Aircraft Operators Association |
| **BIAL** | Bengaluru International Airport Limited |
| **BPCL** | Bharat Petroleum Corporation Limited |
| **CCSIA** | Chaudhary Charan Singh International Airport |
| **CHIAL** | Chandigarh International Airport Limited |
| **CIAL** | Cochin International Airport Limited |
| **CIDCO** | City and Industrial Development Corporation |
| **CP** | Consultation Paper |
| **CPI** | Consumer Price Index |
| **DIAL** | Delhi International Airport Limited |
| **FIA** | Federation of Indian Airlines |
| **FRoR** | Fair Rate of Return |
| **GAL** | GMR Airports Limited |
| **GMADA** | Greater Mohali Area Development Authority |
| **HIAL** | Hyderabad International Airport Limited |
| **HPCL** | Hindustan Petroleum Corporation Limited |
| **HUDA** | Haryana Urban Development Authority |
| **HUDCO** | The Housing and Urban Development Corporation Limited |
| **IATA** | International Air Transport Association |
| **IGIA** | Indira Gandhi International Airport |
| **IOCL** | Indian Oil Corporation Limited |
| **JVC** | Joint Venture Company |
| **KIA** | Kempegowda International Airport |
| **KIAL** | Kannur International Airport Limited |
| **Land Study** | The Land Study report prepared by EY |
| **MIAL** | Mumbai International Airport Limited |
| **NAG** | Nagpur International Airport |
| **NCAP** | National Civil Aviation Policy, 2016 |
| **NPV** | Net Present Value |
| **OMDA** | Operations, Management and Development Agreement |
| **PDCSL** | Pragati Development Consulting Services Limited |
| **PPP** | Public Private Partnership |
| **RAB** | Regulatory Asset Base |
| **RCS** | Regional Connectivity Scheme |

## 2. INTRODUCTION

2.1 Airports Economic Regulatory Authority ("AERA" or the "Authority") of India published the consultation paper (CP) "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" vide Consultation Paper No. 04/2018-19 dated 08.05.2018.

2.2 The Authority acknowledges that the cost of acquiring land for airport development has increased exponentially over time. Therefore, State Governments and Airport Operators are insistent on providing a return on cost of land. The Authority appointed EY to study the issue and submit a report on the FRoR to be provided on cost of land incurred by various Airport Operators in India. EY submitted the land study report on 23 April 2018, based on which the CP was published.

2.3 After publishing the CP, the Authority invited various stakeholders to the Stakeholder Consultation Meeting and written stakeholder comments vide Public Notice .04/2018-19 dated 10.05.2018.

2.4 The Stakeholder Consultation meeting was held on 30.05.2018 in the premises of AERA and the Authority invited written stakeholder comments by 05.06.2018.

2.5 The CP garnered written comments from the following stakeholders:

2.5.1 Business Aircraft Operators Association (BAOA)

2.5.2 Bharat Petroleum Corporation Limited (BPCL)

2.5.3 Airports Authority of India (AAI)

2.5.4 Chandigarh International Airport Limited (CHIAL)

2.5.5 Bangalore International Airport Ltd. (BIAL)

2.5.6 City and Industrial Development Corporation (CIDCO)

2.5.7 Cochin International Airport Limited (CIAL)

2.5.8 Federation of Indian Airlines (FIA)

2.5.9 Hindustan Petroleum Corporation Limited (HPCL)

2.5.10 GMR Airports Limited (GAL)

2.5.11 Mumbai International Airport Limited (MIAL)-GVK

2.5.12 Pragati Development Consulting Services Limited

2.5.13 Indian Oil Corporation Limited (IOCL)

2.5.14 Mr. Sanjeev V Dyamannavar, Bengaluru

2.5.15 Sankhya Consulting

2.5.16 Tripura Transport

2.6 The stakeholder comments are divided into the following seven categories:

2.6.1 Stakeholder comments on rationale of providing return on land

2.6.2 Stakeholder comments on calculation/ methodology to determine rate of return on land

2.6.3 Stakeholder comments on Authority's proposal in the CP

2.6.4 Stakeholder recommendation/ solution to determine a rate of return on land

2.6.5 Stakeholder comments on land development cost

2.6.6 Stakeholder comments on miscellaneous matters

2.6.7 Stakeholder comments pertaining to feedback on EY's report

2.7 This revised CP hereon constitutes Authority's View on the background of the CP, category-wise detailed comments of the above mentioned stakeholders, the Authority's examination and, the Authority's proposal in response to the stakeholder comments received.

## 3. AUTHORITY'S VIEW

3.1 Previously, since the land was acquired by the Government agencies and transferred to the operator free of cost or at nominal value, the regulator did not include the cost of the land in the RAB and did not feel any requirement to pay any return on the cost of the land. However presently, the land is either acquired by the operator themselves and the cost of the land are funded by equity contribution of the shareholders, or acquired by the State Government and transferred to the operator as a part of the equity contribution.

3.2 Historically, the Airports were developed and operated by Governments or PSUs on the land acquired/transferred by State Government or Central Government free of cost. However, it is noted that presently, most of the Airports are being developed on land which are acquired by the operators themselves by paying market price or acquired by State Government and transferred to the operator through equity route. The details of land arrangement for Airport development are given in at Table 1.

**Table 1: Different types of Land Transfer/ Acquisition**

| Type | Case | Return on Land |
|---|---|---|
| Transfer of land from the owner (State Government) | 1. Free of cost | No return on land |
| | 2. Lease basis | Lease rental paid is taken as operating expense.<br>Example: Bengaluru International Airport Limited (BIAL), Hyderabad International Airport Limited (HIAL) |
| Acquired land | 3. Land acquired by Airport Operator against upfront payment | Return yet to be decided.<br>Example: Cochin International Airport Limited (CIAL) |
| | 4. Land acquired by the State govt. and provided to the Airport Operator as equity; | Return yet to be decided.<br>Example: Chandigarh International Airport Limited (CHIAL) |

3.3 In recent years, in airports such as Chandigarh, Cochin, Kannur, land has been provided by the State Government against equity. These State Governments had previously incurred a considerable expense on land acquisition. This has led to a demand of return on land by these State Governments. The Authority acknowledges that refusal to provide such a return could disincentivize acquisition of land which is a primary requirement for airport development. The Authority has recognized this concern in the consultation paper issued for Chandigarh, Goa and Cochin airports. During the consultation process for fixing tariff in case of Chandigarh Airport, the Governments of Haryana and Punjab stated that they have spent a huge amount in acquiring the land for the Airport and they desired to have a return on the investment made by them. It was pointed out to them that the development of the airport land acquired by them indirectly benefits the State Government due to economic development of the area around Airport by way of generation of employment, appreciation in land values, higher tax revenues etc. The State Government pointed out that it takes a long gestation period for areas around the Airport to develop specially for Airports developed at a distance from the city and no immediate benefits are derived by the Government or local population. They felt that in case no return is given on the cost of the land acquired, it might be more beneficial for the State Government to spend the fund on development of other infrastructure which will immediately benefit the Government and local population.

3.4 The Authority feels that the land is a scarce resource and in future, land might not be available for Airport development unless it is acquired by paying the market price. The land cost might be a major component of the total project cost and in case no return is given on the land, the stakeholders might not be interested in investment on the land which may hamper airport development in future.

3.5 The Authority is also of the view that the cost of land for Airports tends to be high as the land in question is located within, or in the vicinity of an urban area. The Authority intends to take the value of land being utilized for aeronautical purpose only providing a return on land cost.

3.6 Further, the development of Airports brings about economic benefits to the concerned region. Thus, in public interest, the Authority proposes that the return on cost of land should be such that its impact on tariff is minimum.

3.7 A meeting of the Stakeholder was held on 30.05.2018 at the AERA office and a no. of stakeholders have given their comments. The comments of the stakeholder have been divided into various sections as per their relevance and elaborated in the next chapter. The comments of the stakeholders, Authority's viewpoint on them and the final proposal is stated for further stakeholders view and comments, if any.

## 4. STAKEHOLDER COMMENTS ON RATIONALE OF PROVIDING RETURN ON LAND

4.1 **CIDCO in respect of Rationale of Providing Return on Land** has stated that

*"…The mechanism for determining the Return on Equity on the land component, may not be fully recoverable due to its impact on tariffs."*

4.2 **CIAL has provided comments on two matters**- the discrimination between airports on treatment of land and the absence of an alternate solution for financing of land acquisition by the private Airport Operators.

**On the matter of the discrimination between airports on treatment of land**, **CIAL** commented that:

*"…If an airport does not purchase land and hold it in the Balance Sheet, but the acquisition is made by the Government and leases it to the Airport Operator, the entire lease expenses will be a pass through cost in the hands of the Airport Operator."*

*"…However, if an Airport Operator purchased the land in its own and hold it and includes it in the Balance Sheet, those category of Airport Operator will not be entitled to any form of returns not even lease rentals. This is again discriminating same class of investment under various ownership/models of Airport Operators."*

**On the matter of the absence of an alternate solution for financing of land acquisition by the private Airport Operators**, **CIAL** commented that:

*"…Some Airport Operators are offered with land acquired by Governments and lease rentals are levied. Perhaps, the present value of all the instalments of lease rentals if equated with the cost of acquisition would better resolve the reimbursement of cost of land in present value terms."*

*"…However, Government can afford not earning return on land, considering the overall economic benefit an airport brings in to the economy. "*

*"…On the contrary, offering one class of airports, who takes land acquisition related risks in its own, with an inferior or nil return is highly inequitable. A deeper analysis may indicate that the Government can offer the same land in perpetuity with lease rentals under the Government land acquisition route, but under the other options, no return has been offered stating a reason that return will have to be have offered in perpetuity to Airport Operators. There are inconsistences and arbitrariness in these approaches."*

4.3 **GAL** has agreed with the Authority's proposition that making land available is the primary obligation of the State Government.

Since they are the prime beneficiary of an airport, it may be desirable that the cost of acquisition is borne by the relevant Government given the positive socio-economic impact an airport brings to the region. Hence, the State Governments should not seek a return on the cost of land acquisition.

However, in cases where a private entrepreneur (and not the Government) bears the cost of land acquisition for airport development; being an economic enterprise, it should be allowed to recover the investment based on defined return on investment.

**The Authority has viewed and acknowledged the comments presented by CIDCO, CIAL, and GAL. In response, the Authority recognizes that state Governments and other stakeholders have been spending substantial amounts of money to acquire land for the purpose of airport development. The rate of return on land for airport development is the subject of discussion in this CP. However, the CP does not intend to discriminate in the ways by which the ownership of land is held while determining the rate of return. The aim of the proposal is to determine and rationalize the return on investment in land when the State Govt. or the Airport Operator acquires the land and treats it as a part of the equity investment.**

4.4 **IOCL** has stated that by providing the land in the form of equity, the state governments in the airports of Chandigarh, Cochin and Kannur would be getting Return on Investment by way of dividend.

**IOCL** further added that Airport Operators charge land rentals in addition to throughput charges. These land rentals are not part of aero charges finalized by AERA, even though aero services are being provided by oil companies. Thus, the plea of Airport Operators that return is not given on land is not entirely true. Furthermore, Airport Operators arbitrarily revise the land rentals at an exorbitant rate.

**Authority's view point**

**The Authority has considered the comments put forward by IOCL and is of the view that land rentals charged by the Airport Operator are driven by commercial agreements. Besides a substantial portion of the land is used for airside facilities such as runways, taxiways, and for passenger facilities and security. No rentals are changed for the use of land for these purposes.**

**It is a fact that the Govt. may get a return by way of dividend. But most of the Airports especially in Tier-II & III cities do not make a profit to pay as dividend. However, it is felt that any return on land should be subject to dividend payable. Moreover, dividend can be paid by the Airport Operator only when a return is provided for it by the regulator in the tariff.**

**The AERA at present considers the land rent paid by Service providers as Aeronautical Revenue. So in case, high land rent is charged, it compensates/ balances the other Aeronautical charges. In future the Authority may think of regulating the land rent charged for Aeronautical Services.**

4.5 **<u>BAOA</u> in respect of Rationale of Providing Return on Land** has stated that

*"…It is the duty of any government to provide infrastructure and an overall eco-system for higher economic growth of the region in an optional and efficient way. Government also has the right to acquire land for such purpose and pay it through public money."*

*"…It would not be fair to increase the aeronautical charges, by even a Small amount, with inclusion of cost of land in RAB due to very thin margins on which air operations become sustainable. The economic benefits to any region, due to availability of an affordable airport, far outweigh the small increase in aeronautical charges due to including cost of land in RAB."*

4.6 **<u>FIA</u> in respect of Rationale of Providing Return on Land** has stated that

*"…Cost of land should not be included in the RAB either directly or indirectly and any type of return on the cost of land needs to be discouraged/disregarded."*

*"…Airlines and passengers must not be burdened with any tariff to be collected to fund the capital investments of a private concessionaire."*

*"…FIA reiterates its submission that there is a critical relationship between passenger traffic and growth of the civil aviation sector."*

*"…Since then the airlines will be able to attract more passengers and the airports would benefit both through higher collection of aeronautical charges as also enhanced non-aeronautical revenue at the airports. In FIA's view, the airport should be regarded as a single business as its aeronautical and non-aeronautical revenues are intertwined."*

*"…Single Till Model ought to be applied to all the airports regulated and operated by the Authority regardless of whether it is a public or private airport or works under the PPP model and in spite of the concession agreements as the same is mandated by the statute."*

*"…Single Till is in the public interest and will not hurt the investor's interest and given the economic and aviation growth that is projected for India, Fair Rate of Return (FRoR) alone will be enough to ensure continued investor's interest."*

**<u>Authority's view point</u>**

**The Authority has regarded the comments presented by <u>BAOA and FIA and</u> is of the view that the responsibility to acquire land for airport development should vest with the State Govt. and its agencies since airport development brings economic benefits and development to the concerned region. Further, it also realizes that the State Governments may have to invest heavily to acquire land for airport development.**

**The indirect return that Govt. may get from investment in land for airports is time consuming. Also the State Govts may consider it more beneficial in case the fund is spent on providing social benefit to population which give immediate results.**

**The Authority, therefore, is of the view that if a return on land is not provided, the State Govt. may not be interested in acquiring land and this could hamper future airport development in the country.**

**The Authority agrees that increased passenger traffic will lead to higher revenues but unless the return on land is included in tariff, the revenues may not be adequate to provide a return to the investor. But there could be a scenario where the city side revenues and non-aeronautical revenues are large and under the hybrid till policy the Airport Operator gets to retain a substantial portion enabling the operator to pay a handsome dividend. In such cases, it may not be necessary to provide for a return on land costs.**

4.7 **Sankhya Consulting in respect of Rationale of Providing Return on Land** has stated that

*"…In cases where the Private Airport Operators wishes to acquire land in densely populated regions it may lead to incurrence of high displacement charges for the settled population in that area."*

*"…Such costs must be absorbed by the private promoter and not passed to other stakeholders including passenger."*

*"…Alternatively an evaluation could be done against the purchase of land and rehabilitation costs vs. establishment of another airport."*

**The Authority is of the view that**

**The land acquisition depends on many factors including social impact of rehabilitation. It is for the land acquiring agency to carry out due diligence process and study such impact and take a view on acquisition Cost towards displacement and rehabilitation is to be absorbed by the Private Airport Operator and not passed on to the other stakeholders/ passengers.**

## 5. STAKEHOLDER COMMENTS ON CALCULATION/ METHODOLOGY TO DETERMINE RATE OF RETURN ON LAND

5.1 **CIDCO** has stated that

*"…When land cost is considered as equity, FRoR may be proposed on case to case basis to recover the historical cost of land using a nominal discount factor.*

*"…The dividends paid out during the period shall be accounted for in the recovery. Effectively, the government equity in the form of land cost shall reduce to zero over the recovery period."*

*"…Perpetual payment of FRoR on the equity contribution and recovery of appreciated market value of land due to the airport development, may be disallowed."*

**Authority's view point**

**The Authority feels that it will not be fair to include the cost of land in the Regulatory Asset Base and provide FROR return on it since land is a non-depreciable asset. In case of land transferred by way of equity, the Authority will allow the return only subject to adjustment of dividend.**

5.2 **Pragati 47 Development Ltd.** offered comments from two perspectives- using NCAP guidelines on liberalizing end-use restrictions on land allocated for commercial purposes and cost of land from a financing perspective

**Regarding use of NCAP guidelines on liberalizing end-use restrictions on land allocated for commercial purposes, Pragati 47 Development Ltd.** stated that

*"…It is well recognized that Airports are catalyst for urban development. Since land for airports and for urban development next to airports is likely to be procured together, a mechanism has to be provided for allocating costs to the two components in a pragmatic manner. It means that land costs for the entire development (airport and urban development next to it) should be taken as a whole and allocated based on commercial viability which will differ in each case. In this scenario, as an example, even if airport takes up 2/3rd of the land mass while urban development takes up 1 /3rd , the cost allocated to airport may be only 25% with the balance 75% being allocated to urban development component."*

*"…If, on the other hand, the urban development is carried out by the same entity as the one developing and operating the airport, the revenues projected to be generated from urban development should substantially mitigate the impact of land cost and keep the tariffs moderate."*

*"…In view of the above, a holistic approach guided by commercial considerations is advised in appraising airport projects cost including land and its financing pattern, for the purpose of determining airport tariffs."*

**Regarding use of NCAP guidelines on liberalizing end-use restrictions on land allocated for commercial purposes, <u>Pragati Development</u>** stated that

*"…The cost of land, from the point of view of financing, has to be taken as a part of the composite cost to be financed by the Project sponsors/ owners. Therefore, the rate of return on the Project cost also has to be seen as a composite return and determined accordingly. Excluding it from RAB as such is not a feasible approach."*

*"…As provided in the Greenfield Airports Policy Guidelines of 2008, the State Government can provide land on a concessional basis, which is a matter of discretion for the State Government. This may not determine AERA approach to calculation of FRoR on land in case the state is unable to bear the burden of procuring land and providing it on lease rental terms for the project."*

**<u>Authority's view point</u>**

**The Authority has acknowledged the comments presented by Pragati Development. Consequently, the Authority opines that the scope of its work is limited to tariff determination of major airports based on aeronautical revenues. Therefore, the cost of land attributable to urban development would be outside the purview of the Authority. Moreover, the return or revenues earned from commercial utilization of land in the developed urban area has already been incorporated. Such returns would offset the aeronautical costs by way of the hybrid till methodology of tariff determination. The Authority has noted that the Airport Operator has a right to retain certain portion of Airport land for non-Airport activity i.e. commercial. The revenue from non-Airport activity should normally subsidise the Aeronautical revenue /charges. If the non-aeronautical revenues and city side real estate revenues of the Airport Operator are fairly significant, the returns for the State Govt. should accrue by way of dividend and not through aeronautical tariff.**

5.3 **<u>HPCL</u> in respect of Calculation/Methodology to Determine Rate of Return on Land** has stated that

*"…It is our suggestion that Land Rentals charged by Airport Operators for fuel farm facilities can be brought under purview of AERA like Fuel Throughput Charges/ Into Plane Charges and its impact on tariff should be minimum."*

**<u>Authority's view point</u>**

**In response to HPCL's comments the Authority is of the view that land rentals that are charged by the Airport Operator are driven from commercial agreements. The Authority may come out with separate consultation paper on land /space rentals chargeable to aero service providers.**

5.4 **Sankhya Consulting** has stated that the total lease rentals over the project tenure must be equal or higher than the acquisition cost.

**In response to Section 5.2.1 of the CP, Sankhya Consulting** commented that Land should be considered as a separate asset block in order to determine the return on it. Land when owned by Airport Operator must not form part of RAB. Return must not be computed using FRoR methodology, because-

• Land intrinsically is a perpetual asset lending to appreciation. Return on land, an asset that is perpetual and appreciating is not feasible

• RAB comprises depreciable assets. Land cannot be included in this RAB for calculation of return.

• In lieu of return on land the Airport Operator can be compensated for cost of land which in turn can be considered as Pass-through.

**Sankhya Consulting** has drawn various scenarios of how return on land should be determined based on how the land is acquired and what is the source of funding of the same.

**1. Airport Operator acquires land from State or private agency**

a. Funding through grant: No return on land; considering that the transaction nature is that of a Grant and since the relationship envisaged is that of a Grantor and Grantee no compensation for land cost is proposed in this case. The over-riding emphasis is on the strategic need for this asset and the socio-economic benefits generated to the ecosystem.

b. Funding through internal accruals: Return on land should be provided at risk free rate obtained from long term Government bond rate (which is used in determining return on equity in WACC by the Authority).

The compensation can be structured similar to a lease rental structure and considered as a pass through.

c. Funding through debt: Return on land should be provided at risk free rate obtained from long term Government bond rate (which is used in determining return on equity in WACC by the Authority).

The compensation can be structured similar to a lease rental structure and considered as a pass through.

d. Pre-funding: No compensation needs to be envisaged in this scenario since it is Pre-funded and involves no cost to the Airport Operator.

Pre-funding in case of Greenfield AAI projects via Asset Development fee could be resorted to by the Airport Operator to fund land acquisition. It is recommended that this be opted for as the last resort since this front-loads the passenger charge and is extremely burden-some in projects such as this which are not only long gestation but typically take longer tenures to stabilise and yield steady returns.

**2. When Airport Operator takes land on lease from the State or private agency:** then the lease rental is paid as return treated as pass through over the entire concession period.

**3. When land is provided in lieu of equity**

Response to section 5.2.2 of the CP:

Where the stakeholder is allotted equity shares in lieu of land provided for the Airport project the equity shareholder could derive benefits by getting returns on such investment either in the form of dividend and/or capital gains at time of divestment. Any return for such investment over and above dividend or capital gains is not considered reasonable or equitable since by nature an investment in equity is a conscious undertaking of risk in the venture for which returns are envisaged in the form of dividends or capital gains.

It is important to note at this juncture that such land which is given for aeronautical purposes also generates revenue from concessionaires, non-aeronautical sources and non-airport activities.

**Authority's view point**

**In response to the above comments by Sankhya Consulting, the Authority concurs in the recognition of land as a separate asset block. Therefore, land would not be included in RAB, given its non-depreciable nature. The Authority also agrees that where prefunding is resorted to for land acquisition there should be no return provided on cost of land. The Authority also feels that there is no rationale for providing return on investment made in land by Airport Operator or by State Govt. and that the Airport Operator/ State Govt. should only be compensated for the amount spent on land acquisition.**

## 6. STAKEHOLDER COMMENTS ON AUTHORITY'S PROPOSAL IN THE CP

6.1 **CIDCO in reference to the Authority's Proposal** has expressed that it is in favor of land cost amortization. **CIDCO** has stated that

*"… Amortisation of the land cost over the period of the concession, such that it does not adversely impact cash flows of the operator and tariffs, is also agreeable model for cost recovery."*

*"…The amortization period should preferably commence after the Airport Opening Date especially for greenfield projects. The historical land cost can be recovered using a nominal discount rate."*

6.2 **CHIAL in reference to the Authority's Proposal** pointed out that the Authority has suggested a return of 3% (by way of amortization) without considering the time value of money.

6.3 **GVK (MIAL) in reference to the Authority's Proposal** stated that the Airport Operator would be unable to recover its costs in both of the scenarios mentioned by the Authority. Therefore, during the concession period, the Authority has to ensure the complete reimbursement of the cost of land in terms of net present value (NPV).

6.4 **BIAL in reference to the Authority's Proposal** stated that it had calculated a negative NPV value for both of the Authority's proposed cases. This implies that under recoveries or losses of such a manner would adversely impact the viability of the project.

6.5 **CIAL in reference to the Authority's Proposal** stated that the Proposal would generate a negative return to investors if the time value of money is considered in the amortization method. Additionally, the present formula of amortizing historical land cost does not include cash outflow on interest payments, in case funds are borrowed to acquire the land. Lastly, CIAL mentioned that an amortization of 30 years and a bank loan of 12-15 years would lead to a mismatch of cash flows.

6.6 **Sankhya Consulting in reference to the Authority's Proposal has** stated that with regard to point 5.1.2 in the CP where the concession term has been fixed as 30 years, it is recommended that the tenure not be fixed at 30 years, but determined with reference to factors such as :-

• tenure of the concession as stipulated in the concession agreement e.g., Bangalore 30+30 years,

• where the airport asset envisaged is to cater to high traffic volume, geographies rendering the asset more capital intensive than usual

• where subsequent capacity expansions would warrant longer gestation periods than usual

Reference to point 5.1.4 in the CP, the use of phrase “aeronautical purpose” should mean airport purpose or airport revenues i.e. aero + non-aero revenues. The Initial or Revised Master plan as applicable could be the basis but periodically the land utilization ratio and activities engaged in, by the airport must be reviewed.

**Authority’s view point**

**The Authority has considered the comments of CIDCO, CHIAL, GVK (MIAL), and BIAL with regards to amortization of land costs. It is cognizant of the fact that amortization of land cost could result in inadequate returns to the investor. Consequently, investors would be discouraged from channeling further funds into airport development. In this regard, the Authority would consider the present value of future amortization in such a manner that the present value of return on land is equivalent to its cost of acquisition.**

**In light of the comments presented by CIAL, the Authority proposes to take into consideration the cost of debt, while deciding on the return to be made to the investor.**

**The Authority takes note of the comments made by the stakeholders. The Authority proposes to amortise the cost of land only in the case of State Govt. transferring land through equity. It is a fact that the amortization of land cost may not compensate for time value of money, however, it is also to be considered that the State Govt. will be benefited from the development of Airport by other means like taxation, investment in surrounding areas, increase in trade & commerce which will compensate the State Government.**

**In case of acquisition by Airport Operator, the Authority proposes to compensate the Airport Operator by giving a return by way of EMI over 30 years period. The calculation of EMI takes into account the amount paid towards the interest component and time value of money. The EMI is to be calculated taking the cost of debt for the Airport.**

## 7. STAKEHOLDER RECOMMENDATION/ SOLUTION TO DETERMINE A RATE OF RETURN ON LAND

7.1 **CIAL has recommended** the following measures:

*"1. FRoR may also be provided on land at par with other class of aeronautical assets in RAB with an appropriate useful life that can be determined by the AERA.*

*2. If admissible, the amortization cost also be made part of the pass through revenue expenditure.*

*3. In case a FRoR cannot be offered and insertion of land cost in to the RAB is not acceptable, a pre-funding mechanism in the form of ADF may be awarded to the Airport Operator, as attracting equity investment and loan financing for acquisition of land will be a difficult proposition.*

*4. In case, point No. 1, 2 and 3 is not acceptable, offer appropriate and comparable lease rentals in perpetuity with annual inflation adjustment."*

7.2 **AAI is of the view** that given options in the Consultation Paper do not fully recover the cost of land. They have recommended that,

"AERA may consider a moderated FROR based on G-Sec reference rate/ Bank rate or any other rate considered relevant for this purpose. Land cost will not be considered as a part of RAB but notionally reduced over a normative period of 30 years for the purpose of providing FROR."

7.3 **GAL has recommended** the following solutions:

**1. When land ownership lies with SPV:**

Limited period concession: Amortization of land over residual useful life and include land cost in RAB and allow FRoR at WACC.

Unlimited ownership: Amortization of land value over 60yrs included as notional value in operational expenditure.

**2. When land ownership lies with the shareholders/others:**

Land provided to the SPV against payment of upfront premium: upfront premium to be part of RAB.

Land provided to the SPV as annual lease: Lease amount to be included in operating expenses.

7.4 **BAOA recommended** that

*"…The model of providing land on lease, amortizing the cost incurred in acquisition of land, on case to case basis would be the balanced approach."*

*"…The balance, between cost of acquiring land and the reasonable aeronautical charges for sustainable operations, should be achieved by amortization through varying rentals on land provided in different phases of lease period."*.

7.5 **<u>IOCL</u> has recommended** the following

*"1. The cost of land should not be considered while finalizing the Aeronautical charges so that the aeronautical charges should not increase."*

*"2. The land rental rate at airports to be brought under the purview of AERA so that an equitable and rational land rental shall be fixed."*

7.6 **<u>CHIAL</u> has recommended as follows**

*"…it is proposed that AERA may please consider/ add cost of land cost in RAB for the purpose of computation of FROR and amortize the cost of land over the period of 30 to 40 years (whichever is suitable to AERA) then such amortization would not be considered as a part of operation and maintenance expense."*

7.7 **<u>GVK (MIAL)</u> recommended** that the Authority should consider the cost of land and reduce the same with the amount amortized each year and consider allowing return by way of WACC on the unamortized cost of land. Amount to be amortized each year should be computed based on balance period of concession agreement. This would ensure that Airport Operator recovers the entire cost of acquisition of land in NPV terms.

7.8 **<u>BIAL</u> recommended** to include the cost of aeronautical portion of airport land into the RAB of the Airport Operator; thereby allowing a FROR 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. BIAL has cited a study by ICAO to justify the socio-economic returns of the airport to the State Government in terms of contribution of national income and employment generation."*

*"…Further, even when State Governments acquire land for airport projects; they are cognizant of the fact that the expenses incurred to acquire 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."*

7.9 **BPCL** **recommended** considering the land rentals charged by the airports to the respective oil companies as aeronautical charges. **BPCL** further added that such charges could be regulated and a formula could be devised that would be linked to the actual cost to the airport market rate.

**Authority's view point**

**The Authority has acknowledged the comments presented by CIAL, GAL, and BAOA. In response, the Authority opines that the rate of return on land when bought in lieu of equity could be based on five factors. Firstly, land could be considered as a separate asset block. Secondly, land for aeronautical use would be used to determine the return on land. Thirdly, the rate of return on land is comparable to return earned by land in alternate cases. Fourthly, the return on land would be defined on a case to case basis. Lastly, the land cost would be amortized at a rate for which the NPV of land cost is zero, i.e. the present value of amortized land value is equivalent to the cost of land acquisition. In consideration of the aforementioned factors, the final rate of return on land could be that which has the least impact on tariffs.**

**The Authority has noted the recommendation expressed by IOCL and is of the view that the mechanism of generating or earning revenue on land is different for each airport. In this context, the outcome of the CP is to determine the return on land, which can be applicable to all airports.**

**CIAL, GAL & BIAL have suggested to include Cost of Land as part of RAB and give a return @ FROR**

**The Authority is of the opinion that the land cost cannot be a part of RAB. The land is not a depreciable asset and needs no replacement. Taking the land cost in the RAB and giving a return on the basis of FROR is not rational and its impact in increasing the aeronautical charge will be substantial. It will also lead to perpetual return on land value for the entire Airport.**

**M/s. GVK has also suggested that return may be given on balance value of land on the FROR after amortizing the value for the year. It may be noted that the suggestion for amortization is only for Govt. Agencies and not for land acquired by Airport Operator themselves. In case of land acquired by Airport Operator, AERA proposes to give return on the basis of EMI for 30 years which takes into account the interest /component.**

**As to the comments of BIAL, the regulator is of the same view that prima-facie it is the responsibility of the State Govt. to provide land free of cost and they should not be given any return on the same. However, in a number of cases, the State Govt. has stated that the acquisition of land involves huge cost and they will not prefer to acquire land unless they get some return on it.**

**M/s. BPCL has asked the land rent to be regulated. At present, the land rent is not regulated, Authority proposes to come out with a paper on the issue of land rent charged to the Aero Service Providers.**

## 8. STAKEHOLDER COMMENTS ON LAND DEVELOPMENT

8.1 **GVK (MIAL) in respect of Land Development Cost** has commented that there are no assets being created on certain areas of the airport land. Consequently, there is vacant land in areas between taxiways, spaces between apron and the perimeter road, etc. The Authority needs to provide clear guidance on the treatment of land development cost in such cases. **GVK (MIAL)** has suggested certain approaches

*"…i). Allocating the cost attributable to developing such vacant / unused tract of land to the multiple assets built around such tract of land and allow recovery through amortization of the cost coupled with return on unamortized cost; or*

*ii) If in case it is not possible to allocate such land development cost to any assets developed around such tracts, treat such costs in terms of Order no. 35 1201 7-18 dated 12 January 2018 "Determination of Useful Life of Airport Assets" and Amendment no. I thereto. Accordingly such land development cost should be considered as a part of RAB and be amortized over the lease period, in view of order by Authority on useful life of assets (Sr. No. 2 on Annexure I "Useful Life of Assets")"*

Additionally, **GVK (MIAL)** stated that the Authority should clarify that proposal 5.3 is applicable both to Own land as well as Leased land.

8.2 **Sankhya Consulting in respect of Land Development Cost** has commented that to enable the Airport Operator to recover investment in airport infrastructure it is important that land development cost such as land levelling costs etc., are identified to specific infrastructure and facility components such as taxiway, runway etc., since these can then be depreciated and recovered via the tariff computation.

**Authority's view point**

**The Authority is of agreement that the cost of land development for a specific asset needs to be considered and has proposed in CP to add the land development cost to the Cost of Specific Asset. In case the land is associated with a particular asset, the land development cost can be added to the Cost of Asset. The cost towards displacement and rehabilitation will not be included in land development cost.**

**For example, land development cost around runway kept vacant can be added to runway cost.**

## 9. STAKEHOLDER COMMENTS ON MISCELLANEOUS MATTERS

9.1 **Mr. Sanjeev V. Dyamannayar** has referred to the case of BIAL, on how airport investor has missed Non Aeronautical Development on additional land provided, which is hurting Airport revenue.

**Mr. Sanjeev** also pointed out that the BIAL Management failed to utilize excess land for Commercial Exploitation and imposed additional encumbrance on Air Passengers through UDF. Moreover, other stakeholders such as GOK and GOI would not receive any returns as well.

**Mr. Sanjeev** suggested the following changes for AERA to consider while determining FRoR for Cost of Land incurred by the concerned Airport Operators of India

*"…1. **Running Cost of Land :** Rental Cost / Land Taxes of Non Utilized portion of Land should not be considered if land is not been exploited after 5 Years period from the Date of Airport opening*

*2. **Penalty to be imposed:** AERA should stipulate the time limit within which Airport Owners like BIAL to submit Real Estate Business Plan for commercial exploitation of land so that it can be appropriately factored in determining aeronautical tariffs (including UDF) for the control period. If they fail to act, Airport Operator should be provided negative incentive for failure to act. Percentage should be decided by AERA."*

**Authority's view point**

**The Authority has noted the concerns of the stakeholders and is of the view that the Airport Operator should take responsibility for development and utilization of land meant for commercial development. The land rent/ revenue from commercial development is not regulated and the operator is free to fix rate/charge for it. No Airport Operator would want to miss out on earning revenue from real estate development since the operator can retain a significant portion of such earnings. The Authority is of the view that no return should be given for such land and it is further proposed to provide a return only in respect of land earmarked/utilized for Aeronautical purposes.**

## 10. STAKEHOLDER COMMENTS PERTAINING TO FEEDBACK ON EY'S REPORT

10.1 **CIAL dismissed the land study report submitted by EY** for three reasons. Firstly, the Report was not aligned with the price cap regulation frame for Indian Airport Regulations. Secondly, the benchmarking method was not proper with regards to practices within and outside of India. Lastly, the report did not abide by the TOR.

CIAL further added that CIAL was wrongly categorized under the fourth category of type of land arrangement in the Consultation Paper.

10.2 The Authority has noted the comments of CIAL. In response, the Authority is of the view that the report has served as a background paper on the subject and further comments are welcome. Additionally, any factual error may be regarded as unintentional.

## 11. AUTHORITY'S EXAMINATION – SUMMARY

The Authority has reviewed the stakeholder comments. Following is the summary of key points that have emerged in the stakeholder comments:

11.1.1 Airport development results in socio-economic benefits to the government. This needs to be factored in while deciding on the returns to be provided on the cost of land acquired by the Govt. for airport development.

11.1.2 The methodology of providing rate of return on land as proposed by the Authority in the CP does not take time value of money into consideration resulting in negative NPV. The return provided to cost of land should result in a non-negative NPV, so that the Airport Operator recovers the entire cost of acquisition of land in NPV terms.

11.1.3 The rate of return to be provided on cost of land should be in line with the cost of financing used to acquire/ procure such land on a case to case basis.

11.1.4 The time period for which return is to be provided on cost of land should be in line with the time period of financing used to acquire/ procure such land on a case to case basis.

11.1.5 While determining the return on land, the Authority on case to case basis may consider proceeds such as, rental revenue (when land leased out by Airport Operator), dividend (when land infused as equity by Airport Operator) and proceeds from sale of land.

## 12. AUTHORITY'S PROPOSAL

**After careful examination of the stakeholder comments, the Authority proposes the following:**

12.1.1 **In case land is provided free of cost, then no return shall be given on land.**

12.1.2 **The return will be given only on land used for aeronautical activities marked and approved by the Leasing Authority. The Authority may also assess the requirement of land for aero purpose.**

12.1.3 **In the case of privately acquired land by Airport Operators the return shall be in the form of Equated Yearly Installment at par with interest on debt, for a period equivalent to original lease period or 30 years, whichever is lower.**

**The EMI on cost of land attributable to aeronautical activities can be computed using the below mentioned formula:**

**EMI = [P x R x (1+R)^N]/[(1+R)^N-1]**

**where,**

**P is the principal amount equivalent to cost of land under aeronautical activities,**

**R is the interest rate per year, and**

**N is the number of yearly instalments**

12.1.4 **In the case of leased land, the yearly rental charged will be allowed subject to rationale of lease rental being paid. The lease amount shall be a pass through expenditure.**

12.1.5 **In the case of Government acquired land handed over to the airport- as part of equity infusion, the land cost shall be amortized over a period of 30 years. The amortized amount will be a pass through in case the amount is paid to the Govt. However, any dividend paid by the operator to the Govt. during the year will be deducted from the amortized amount.**

12.1.6 **The cost of land will be subject to due diligence. The Authority will allow compensation only on fair value of the land.**

12.1.7 **The Authority would suggest to State Govts to acquire adequate land so that city side development is possible and the revenues therefrom provide the necessary returns on the investment in land. The State Govts may also factor this, while deciding on the basis for providing the land for airport development.**

13. **STAKEHOLDERS' CONSULTATION TIMELINE**

13.1. In accordance with the provision of Section 13(4) of the AERA Act, 2008, the proposal mentioned in Para 12 above read with the relevant discussion in the other sections of the paper is hereby put forth for Stakeholders' Consultation. For removal of Doubts, it is clarified that the contents of this consultation paper may not be construed as any order or Direction of this Authority. The Authority shall pass an order, in the matter, only after considering the submissions of the Stakeholder's in response hereto and by making such decisions fully documented and explained in terms of the provisions of the Act.

13.2. The Authority welcomes written evidence- based feedback, comments and suggestions from Stakeholder's on the proposal made in (Para 12 above), latest by **22.10.2018** at the following address.

**Secretary**
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**(S. Machendranathan)**
**Chairperson**