APAO/AERA / 2021-22 **Date: 20th July 2021**

Director (P&S)
Airports Economic Regulatory Authority of India (AERA),
AERA Administrative Complex,
Safdarjung Airport,
New Delhi – 110 002

Subject: **APAO response to Consultation Paper No. 10/2021-22 dated 22nd June 2021 in the matter of determination of aeronautical tariff for Kempegowda International Airport, Bengaluru (BLR) for the Third Control Period (01.04.2021-31.03.2026)**

Dear Sir / Madam,

As the apex industry association of all major private airports operating in India, APAO is pleased to share its responses on the Authority's proposals in the abovementioned Consultation Paper for the kind consideration of the Authority.

BIAL has been one of the most successful greenfield PPP airports in the world with KIAB being one of the fastest growing airports in the pre-Covid world and the only airport in the world to be consistently rated as the best airport for departures as well as arrivals in its category by Airports Council International (ACI).

The Covid Pandemic has severely impacted the aviation sector leading to an unprecedented fall in passenger traffic across the world. The fall in traffic and various lockdowns due to the Covid Pandemic have adversely impacted BIAL's finances and expansion projects. Despite this, BIAL has extended support to different stakeholders across the aviation ecosystem including airlines, ground handlers, fuel suppliers, non-aero concessionaires, etc., by providing a range of financial waivers and deferments.

Given the above background, **we would like to highlight our inputs on certain key matters.**

Traffic Forecast for 3rd Control Period

While we hope for a fast recovery in traffic aided by the vaccination programme launched by Government of India (GoI), we believe that AERA has assumed an over-optimistic traffic forecast for KIAB for the Third Control Period, which appears inconsistent with the feedback from aviation agencies like ICAO, ACI, IATA and also differs greatly from the assumptions considered by AERA for Delhi and Mumbai Airports in their recent tariff determination process as well as from the traffic assumptions proposed for the ongoing tariff consultation processes for Hyderabad Airports for the same period, which has been published on 2nd of July 2021 (just 10 days after the consultation paper was issued for KIAB).

Traffic growth rates assumed are wholly unrealistic considering performance in the first quarter of this year and time taken for recovery, supply side challenges and airline network reconstitution.

In light of the facts and points mentioned above, **we would request the Authority to consider moderating the traffic estimates between 160-165 million and accordingly revise its proposal during finalization of the tariff determination Order for BIAL**. It is important to specifically tone down the international traffic with the restrictions on travel imposed in the Indian & International airports on account of Covid pandemic.

Withdrawal of Financing Allowance

Direction No. 05 / Airport guidelines (published by AERA on 28th Feb 2011) is the core of the Regulatory Philosophy and has been the basis for issuance of all Tariff Orders by the Authority. Direction 5 allowed Airport operators to be eligible for Financing Allowance and The same was allowed and approved by AERA in the tariff orders passed by Authority for BIAL (for the 1st & 2nd Control Period).

BIAL achieved financial closure for the Expansion project based on the applicability of Financing Allowance and both lenders and shareholders have invested their share based on the tariff orders approved by AERA in the 2nd Control Period. The Authority has now proposed not to allow Financing Allowance as prescribed in Direction 5, which is not in line with the established guidelines as provided in Direction 5 issued by AERA. No stakeholder consultation process has been carried out to reverse / override the established guidelines.

Such changes to Regulatory principles, in contravention to Authority's own Guidelines and one which had been followed in the past tariff orders, creates doubts regarding consistency of the Regulator's approach while adding to the doubts in the minds of Investors & Lenders.

Accordingly, **we would request the Authority to honour its own guidelines and airport regulations and allow Financing Allowance as claimed by BIAL**.

Changes to Useful Lives of Assets

We note that the Authority has proposed changes to the useful life of assets in computation of depreciation, which was approved by the Authority in the previous tariff order.

AERA had issued Order No. 35 /2017-18 dated 12th Jan 2018 for determination of Useful life of Airport assets and followed it up with an Amendment to Order No.35/2017-18 dated 9th April 2018. The above referred Orders allows for the useful life of Runways/taxiways to be between 20-30 years. Further, extra shift depreciation for Plant and Machinery in the case of large airports, running continuously for extra shift, was also allowed, based on technical justification.

Authority had accepted the technical justification given by BIAL in the 2nd control period and had adopted the same at the time of issuance of tariff order for the 2nd control period. However, the Authority has now reversed its position and has gone against its own orders regarding depreciation. We do not understand the reason behind the Authority's sudden change of position as it goes against what it decided in the 2nd tariff order.

We would request the Authority to honour its own decisions taken in previous tariff and consider useful lives as claimed by BIAL.

Interest rates for 3rd Control period

AERA has considered BIAL's existing interest rate of 7.85% for the entire tenure of 5 years of the 3rd Control Period as against BIAL submission of 10%. The economic growth forecast for India for FY22 has also been revised downward with RBI lowering its forecast to 9.50% while World Bank and S&P have lowered the forecast to 8.3% and 9.50%, respectively. BIAL has tied up debt for the Expansion project at 7.85% and this is one of the lowest in the airport sector. Interest rates have bottomed out and they are only expected to raise and not stay at the current levels. Since the project loan interest rates are linked to MCLR rates issued by the lending banks, the movement upwards of the MCLR rates also necessarily increase the interest rates on the project loans. The Bank MCLR rates at their historic lows and the past experience have shown that over a 5-year period, they definitely average higher than their historical lows.

We request Authority to consider 9% (interest rate for 2nd Control Period) as cost of debt for the 3rd control period and true up of the same in the subsequent control period.

Consideration of Notional lease rentals

We have observed that the Authority has proposed to consider a notional lease rental from BAHL (100% subsidiary of BIAL) from the Airport opening date. It is a matter of fact that the Hotel started operations only in 2016-17 and we are unable to understand as to how AERA can ascribe lease rentals to an asset for the period when it was not even operational and was actually in various stages of construction.

In light of the above, **we would request AERA to re-examine the issue of charging notional rentals for the period when the said asset itself was not operational and not consider them for tariff determination.**

O&M costs for 3rd Control period

We have observed that the Authority has projected O&M costs without considering the past trends and has proposed radical norms that have not been seen till date in any of the major airports or proposed in the past AERA Consultation papers or tariff orders.

The Authority had appointed an independent consultant to determine efficient O&M costs for BIAL with respect to its performance (Internal benchmarking) and its competitors (external benchmarking) for the 2nd Control Period (FY2017-2021). As per the report submitted by the independent consultant, the overall (total) operational expenditure incurred by BIAL for the period FY 2017 – FY 2020 appears reasonable and within the range of other private airports in India.

However, the Authority has completely ignored this report while projecting the O&M costs for the 3rd Control Period and has proceeded to adopt O&M norms which are hitherto unheard of in the airport sector & is totally devoid of any rationale and reasoning.

The assets that are getting added to the Asset Base are new but as the Authority is aware, the nature of O&M in the airport sector is characterized by the heavy "fixed" nature of O&M costs. New assets added during the period would have costs including AMC, general maintenance, housekeeping, consumables etc. This critical input has been totally ignored by the Authority.

We request the Authority to apply rationale norms for estimating the O&M cost for new assets and also follow the principles followed in DIAL and MIAL 3rd tariff orders, wherein the Efficient Costs report prepared by the independent consultant was used as the basis for projecting O&M expenses in the current control period.

Non-Aeronautical Revenue Projections

We have observed that the Authority has assumed an over optimistic growth rate for Non-aeronautical revenues, & the growth rates are much higher than the rates adopted in the recent DIAL & MIAL tariff orders.

On account of drastic fall in traffic, non-aeronautical income of airport operators has been severely impacted and this has affected the profitability of the operators.

Authority has projected the return to Pre-Covid levels by FY 2023. The Authority, in DIAL and MIAL 3rd control period tariff orders, had considered a return to pre-Covid levels in FY 2024 only. These 2 airports have substantial international traffic when compared to BIAL.

International Traffic contributes substantially to the non-aeronautical revenues and in the absence of recovery of the same, the assumption made by AERA in regard to non-aeronautical revenues appear misplaced and not realistic.

DIAL & MIAL orders were issued before 2nd wave of Covid hit the country & it is hard to understand as to how BIAL can recover faster than DIAL & MIAL. Moreover, scheduled international flights are yet to commence and considering the uncertainty regarding international traffic recovery, we are unable to understand the logic behind AERA's projections. In fact, BIAL's international traffic as a percentage is much lower as compared to DIAL & MIAL.

We therefore request Authority to apply the principles followed in DIAL and MIAL tariff orders regarding recovery of Non-aeronautical revenues to pre-Covid levels.

Non-consideration of pre-AOD period shortfall for tariff determination

BIAL started operations on 24th May 2008, much before AERA came into existence. BIAL had suffered losses in the first year of operations, on account of inadequate tariffs. Additionally, BIAL has also incurred losses of Rs. 53 crs, prior to the date of airport opening (FY 2006-2008). This was on account of non-capitalization of preliminary expenses due to the then prevailing accounting standards. Hence, these expenses had to be charged to the P&L statement and this resulted in loss on the opening date of the Airport. The same is reflected in the annual reports of BIAL also in the respective years.

TDSAT, in its judgement dated 16 December 2020, had directed AERA to look into the entire pre-control period for consideration on merits. While the Authority has considered the losses incurred by BIAL in the 1st year of operations, it has not considered the losses (Rs 53 crs mentioned above), which are prior to the Airport Opening Date.

Being a regulated entity, this loss can only be recouped through the tariff mechanism for the subsequent period. Denial of this recouping mechanism is against principles of natural justice to BIAL, as the loss is on account of accounting standards and not because of BIAL.

The Authority is requested to consider pre-AOD losses as per the direction of TDSAT and not resort to partial consideration of pre-control period losses.

Disallowance of approved Capital Expenditure in Tariff determination towards Preoperative costs earlier allowed in the 2nd Control Period tariff order

AERA has disallowed capitalization of preoperative expenses of Rs. 355 crs incurred by BIAL towards Expansion project. These are expenses incurred for having a dedicated Project team that is responsible for implementation of the Expansion Project by working along with a team of international consultants.

In the Consultation Paper, the Authority has stated that these costs are "redundant". However, in the 2nd Control Period Tariff order, when the entire Expansion project costs were approved, after extensive due diligence and analysis, Authority had acknowledged that there is a need to have a dedicated Project Management team when large scale capital expenditure Projects are being executed.

It had also approved an ad-hoc amount of Rs. 150 crs as the pre-operative expenses and stated that it would be trued up after the Projects are commissioned based on study of the actual cost incurred and its reasonableness.

Pursuant to the tariff order issued by AERA for the 2nd Control Period (FY 2017-21), BIAL had achieved financial closure for the Rs 13,352 crs Expansion plan and invested more than Rs 2400 crs of equity into the Expansion Project which includes pre-operative expenses.

Authority's revised stand is in contravention to their own legally valid order No.18/2018-19 dt. 31st August 2018 and this disallowance will severely impact the cash flows of BIAL. Authority has not conducted any study and the Project construction is ongoing. Given the above, to summarily reject a major cost head (that was already approved by it) is unheard of, especially given the fact the same Authority had approved pre-operative expenses in the case of Delhi and Mumbai airport expansion projects in the recent past and has also been proposed in the consultation paper for GHIAL by AERA recently.

We request Authority to reinstate the pre-operative expenses as approved in the 2nd tariff order and true up the same at the time of completion of the projects based on actual costs incurred and its reasonableness.

Conclusion

The Consultation Paper has raised some key concerns, both on the Expansion Project under implementation, and the adequacy of cash flows towards meeting BIAL's operational costs and debt-service obligations over the next 5 years of the 3rd Control Period.

In these uncertain times, there is a need to have a fair, realistic and consistent approach to economic regulations that should take cognizance of the impact of the Covid Pandemic on the sector, while addressing the concerns of all the stakeholders.

In summary, we would like to request a more realistic, fair, and consistent approach to tariff determination by AERA.

Kempegowda International Airport, Bengaluru (KIAB/ BIAL) has been inducted into the prestigious Airports Council International (ACI) Director General's Roll of Excellence for the year 2020 for consistently delivering superior customer service. Instituted in the year 2011, the Roll of Excellence recognises airports, which in the opinion of the passengers, have demonstrated strong commitment towards service quality.

Their intent is to create world-class infrastructure for the City of Bengaluru and State of Karnataka and are focused on providing capacity, despite Covid-19's staggering impact on traffic and revenues to meet forecast medium and long-term demand.

In case any information/ clarification is required, please inform the undersigned.

Thanking you.

Yours faithfully,
For Association of Private Airport Operators (APAO)

Satyan Nayar
Secretary General
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APAO Points made for BLR Airport CP

From : snayar@apaoindia.com Sun, Jul 11, 2021 03:43 PM
Subject : APAO Points made for BLR Airport CP 1 attachment
To : Jaimon Skaria <jaimon.skaria@gov.in>

Dear Mr Jaimon Skaria

Please find below for your records and ready reference the points made by APAO in the AERA Stakeholders Meeting held on 9th July 2021 on the BIAL CP.

APAO Points for BLR Airport CP

1) Traffic projections for BIAL need to be aligned to a common set of principles that AERA should adopt for all major airports:

a. We humbly submit that the PAX traffic projections put forth by AERA for BIAL appear to be extremely optimistic and do not match with any published literature of forecasts done by ICAO, ACI or any aviation consultant. While the 2nd wave of covid 19 is now behind us , the indian aviation sector continues to struggle with passenger traffic, fuel prices, rising debt levels, high taxation, and the uncertainity of when recovery can be expected, given the nature of pandemic and its wave of infections.
b. We have all witnessed an unprecedented slump in the passenger traffic numbers as a result of Covid, which has set the industry back by 13 years.
c. It is observed that in FY21 we achieved a PAX traffic of 115 M (105 M Dom +10 M Intl). This is exactly what we had achieved in FY 2008 of 115 M PAX (85 D + 30 I).
d. And in FY19 & FY20 we had achieved a total PAX traffic of 345 M (275D + 70I).
e. Now to recover from such a massive setback is going to take a long period of time(we expect it will take at least a couple of years). Some of the reasons as to why it will take this much of time are for the following reasons as mentioned below:

- The inherent fear of traveling by passengers for the fear of getting infected. We think this is the real issue on hand for all stakeholders not only in the aviation sector but also in the tourism and hospitality sectors, as to how to allay the fears of travelers
- No one can predict if and when a 3rd wave would occur. The recently published SBI research report is indicating the possibility of the third wave in Aug / Sept 2021 that could last for 98 days !
- The availability of vaccines and the speed with which it would get rolled out. In the Indian scenario, even for domestic travel vaccination drives will determine how soon the industry revives.
- Then there are issues related to acceptability of vaccines by different countries, and the element of distrust amongst countries on acceptance of vaccines used by travelers. Example of COVISHIELD vs COVAXIN
- The uncertainty of opening up of normal intl. travel to and from India due to border restrictions imposed by several countries. Hence, it is expected that intl. flights are likely to continue under bubble agreements in FY22.
- Rising prices of crude oil & ATF is a dampener.

- **In today's time the harsh reality is that Virtual Meetings have become the new norm now replacing physical presence meetings including for Conferences. This trend is likely to continue for long affecting Corporate & Business travel both for domestic and International flights**
- The outlook for airport traffic will to a great extent be influenced by the structure and growth of the airline industry which at the moment remains quite uncertain. It is also not known how fast the Tourism and Hospitality sectors would get revived. As we all know these sectors have a very important role to play in promoting air travel, but then these sectors would have to first adopt robust Covid safety protocols and then also ensure that all workers and persons connected to the Tourism & hospitality ecosystem get vaccinated. All this is going to take a considerable period of time.

f. It is also pertinent to mention that larger airports are expected to take longer to recover as they depend on feeder traffic while the market is witnessing a shift towards greater point-to-point traffic (Tier 2 to Tier 2 flights).

So with all these uncertainties and variables existing due to the nature of pandemic and its wave of infections it may be considered by AERA to initially accept the PAX projections provided by BIAL and if required, consider a mid term review of the PAX traffic projections (say after 2 years).

2) Penalty proposed for Capital program:

a. At a time when India has just managed to emerge from a crushing 2nd Covid wave and there are concerns about a 3rd wave, proposing a penalty for non-completion of a CapEx program literally amounts to asking airports (like BIAL) to prioritize construction progress over ensuring Covid appropriate procedures.

b. Because of the pandemic PAX traffic has been severely affected due to which PPP airports are expected to have significant over capacity over the next few years. Already both Delhi and Mumbai airports last 1 year have been operating with just 1 terminal.

c. As we are all aware that due to lockdowns imposed by different States a significant number of workers engaged by contractors at construction sites had migrated to their respective hometowns for long periods and thereby putting a halt on all construction activities. In such situations delays in project completion were bound to happen. It would therefore be very unfair to impose any penalty on airports for any delays in completion of their capex program.

d. We would therefore request AERA to kindly consider these ground realities and not impose any penalty.

3) Lack of consistency in approach to tariff determination wherein approach proposed for 3rd Control Period varies from the approach proposed for 2nd Control Period

Regulatory regime consistency with respect to the existing policies, directions and guidelines of AERA and consistency with respect to decisions taken in the past orders are paramount for investors & lenders. They should not be reversed/rolled back in a retrospective manner, unless there is an appellate ruling or such a change is a part of wider consultation in regard to revision of existing airport regulations, as these frequent reversals will affect Airport operator’s financials and create cause of concerns for lenders & investors.

Thanks & Regards

Satyan Nayar
Secretary General

Inline image 2

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