Email **RAM KRISHAN**

Response to Consultation Paper issued by AERA for 3rd Control Period

From : amy tan <amy.tan@fihmauritius.com> Tue, Jul 20, 2021 10:29 AM

Subject : Response to Consultation Paper issued by AERA for 3rd Control Period 1 attachment

To : RAM KRISHAN <director-ps@aera.gov.in>, Jaimon Skaria <jaimon.skaria@gov.in>, Manu Sooden <Secretary@aera.gov.in>

Cc : info@fihmauritius.com

To,

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

Sub: Response to Consultation Paper issued by AERA for 3rd Control Period

Ref: Consultation Paper No 10/2021-22 published by AERA on 22nd June 2021

This has reference to the Consultation Paper No. 10/2021-22 published by the Airport Economic Regulatory Authority (AERA) for the 3rd Control Period for Kempegowda International Airport Bengaluru (KIAB) on 22nd June 2021.

As shareholders of BIAL, operator of KIAB - 1st greenfield airport in India on PPP basis, we have keenly followed the tremendous growth in the Indian aviation sector. Pre Covid 19, India was forecasted to become the 3rd largest aviation market in the world by 2030. Government of India (GoI) had taken a slew of measures in the past like 100% FDI in airports, UDAN – Regional Connectivity Scheme etc to boost investment and connectivity.

In the Union Budget for FY2022, GoI has announced that 13 airports operated by Airports Authority of India (AAI) have been identified for privatization and that the possibility of clubbing of profitable and non-profitable airports will be explored to make more attractive packages. Besides this, the monetization of operating public infrastructure assets to the tune of □2.5 lakh crore has also been announced by GoI, which includes sale of AAI’s stakes in the country’s top metro airports of Delhi, Mumbai, Bengaluru, and Hyderabad. Collectively, these metro airports handle more than half of the country’s overall air passenger traffic.

The scale of current and forecasted demand at Indian airports requires significant investment to maintain and enhance infrastructure capacity. The past bids for operating AAI airports and the development of greenfield airports have proven that the partnership between Government and Private sector is the only viable option for the development of the airport sector in India.

A fair and consistent regulatory framework is a critical requirement for the success of the entire airport sector in India. Such a framework is viewed as a promise to the Investors, who may feel secure and confident of a fair treatment, after they have agreed to make or made heavy investments.

The above referred Consultation Paper has raised serious concerns on the Expansion Project under implementation, the adequacy of cash flows towards meeting BIAL's operational costs and debt-service obligations, and reasonable returns to the shareholders for taking risks and committing such a large investment over the period of 5 years in the 3rd Control Period. Please note that the shareholders of BIAL have pledged their shares in BIAL as a collateral to the BIAL lenders and any default by BIAL on the lenders' repayments, will result in the pledge getting invoked, which is completely undesirable.

We are very concerned that if the Authority's proposals in the Consultation Paper are the ones that are finally determined, the resultant outcome is likely to seriously impact the progress of overall Expansion Project and lead to cash flow shortfalls affecting the economic and viable operations of the company. This shall significantly impact the confidence of the Investors and Lenders in the sector who have committed to infrastructure growth in India.

Issues of Concern in the Consultation Paper

Investors have strongly relied on the policy framework established by AERA (through its own guidelines and past tariff orders), TDSAT orders and Government policies. The reversal of some of these accepted and adopted policies and principles has shaken our confidence.

Certain proposals in the Consultation Paper are contrary to the Airport Regulations/ previous Orders of the Authority in relation to the capex spends. We request AERA to consider the following submissions to address our key concerns in the Consultation Paper, which will go a long way in restoring the Investors' confidence in airport projects in India.

1. **Fairness in Treatment**

Disallowance of Project pre-operative costs

- These are expenses incurred for having a dedicated Project team that is responsible for implementation of Expansion Project by working along with team of international consultants.
- Contrary to the decision taken in the 2nd control period tariff order, AERA has now disallowed the entire cost of Rs. 355 crores and this disallowance will severely impact the cash flows of BIAL.
- In the 2nd control period order, Authority had acknowledged that there is a need to have a dedicated Project Management team when large scale capital expenditure Projects are being executed.

- Authority had approved pre-operative expenses in the case of Delhi and Mumbai airport expansion projects in the recent past and has also proposed pre-operative expenses in the consultation paper issued for GHIAL recently.

We request the 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.

2. **Consistency in Regulatory Approach**

a. **Withdrawal of Financing Allowance**

- Financing Allowance as per Direction No. 05 was followed by AERA in the last 2 tariff orders. This was the basis for lenders and shareholders to commit their share of investment in the Expansion Project.
- AERA has inconsistently revised the concept of Financing allowance in the 3rd Control Period and this will seriously affect the cash flows and ability to service debt service obligations of the company, especially since BIAL has invested 100% of the equity (amounting to Rs 2,425 crs) prior to debt disbursement.
- 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.

We request the Authority to honour its own guidelines and airport regulations and allow Financing Allowance in line with the principles applied in the tariff orders of the prior control periods.

b. **Changes to useful life of assets in computation of depreciation**

- Authority has proposed changes to useful life of assets in computation of depreciation, which was previously approved by AERA in the previous tariff order.
- AERA has disregarded its own principles /decisions taken in past orders regarding useful life of assets for the purposes of computing the depreciation in the 3rd Control Period, without assigning any reasoning or rationale for the change in its position.

We request the Authority to honour its own guidelines and airport regulations and allow Financing Allowance in line with the estimates used in the tariff orders of the prior control periods.

3. **Realistic Assumptions to ensure adequate cash flows:**

a. **Traffic Projections**

We believe that AERA has assumed an 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 by AERA for the ongoing tariff consultation processes for Hyderabad Airport for the same period, which has been published on 2nd of July 2021.

Traffic growth rates assumed are unrealistic considering performance in the first quarter of this year and time taken for recovery, given the COVID impact on aviation sector.

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 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.

b. **Non-Aeronautical Revenues**

Authority has assumed an optimistic growth rate for Non-aeronautical revenues for BIAL. The assumed growth rates are much higher than the rates adopted in the recent DIAL and MIAL tariff orders. Because of drastic fall in traffic, non-aeronautical income of airport operators has been severely impacted and this has affected the profitability of the operators.

The recovery period and growth thereafter of non-aeronautical revenues appear unrealistic, as the passenger profile, travel habits and behaviour are poised to undergo significant changes post Covid 19.

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.

c. **O&M costs**

The assumptions on O&M costs for new asset additions are unrealistic and unsustainable. 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 follow the principles followed in DIAL and MIAL 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.

d. **Interest Rates**

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%.

BIAL has tied up debt for the Expansion project at a floating rate of 7.85% and this is one of the lowest in the airport sector. Interest rates have bottomed out and they are only expected to rise in future and not stay at the current levels. The Bank MCLR rates at their historic lows and the past experiences 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

Conclusion:
The issues of concern mentioned above, will have a bearing on the cash flows of BIAL for operations, payment of concession fees and statutory dues and meeting financial covenants and debt obligations. Airport cash flows have shown resilience in previous economic downturns. But the COVID pandemic has affected this aspect and unless adequate cash flows are provided through appropriate tariffs, viable operations of the airport are at great risk.

We request the Authority to have objective and realistic assumptions such that it leads to predictability and consistency in cash flows.

The Covid Pandemic is unlike an economic crisis the world has seen and would financially impact nations or regions. In addition to creating financial woes and weakening the spending power, this pandemic has the potential to change consumer behavior and aviation sector irrevocably.

There is a need for greater collaboration between the authorities, government and stakeholders for reviewing the situation and taking necessary steps to survive the crisis and revive the sector. We are optimistic that the Authority will take necessary steps in that direction and ensure that the airport operator is provided adequate cash flows and maintain consistency in guidelines/ policy implementation.

We request that our views expressed above be taken into consideration by the Authority at the time of issuing the final tariff order.

Yours sincerely,

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