GVK

MIAL/VPR/208-19/04

11th June, 2018

The Secretary,

Airports Economic Regulatory Authority of India,

AERA Building, Administrative Complex,

Safdarjung Airport,

New Delhi – 110 003

Madam,

Sub: Response to AERA Consultation Paper No.4/2018-19 dated 8th May, 2018 in the matter of Determination of Fair Rate of Return (FROR) to be provided on Cost of Land incurred by various airport operators of India.

We have gone through the proposal referred in the above said Consultation Paper and appreciate the opportunity given by the Authority to provide our comments, which are detailed below.

A) Rate of Return to be provided on cost of land where airport operator is required to bear the cost of acquisition of land

Based on the study conducted by EY, the Authority has discussed and analysed two scenarios, where:

In scenario 1, the airport operator has to recover the cost of land on the basis of FRoR on cost of land over the concession period or remaining term of concession period. With FRoR on cost of land @12%, the cost shall be recovered in absolute terms over a span of 9 years, however, the net present value of such cash flows works to just about 64% of the cost of land.

In scenario 2, the airport operator has to amortize the cost of land at a fixed rate until the time the cost is realized. With amortization rate of 3.33% p.a., the cost of land shall be recovered in the absolute terms over a span of 30 years, however, the net present value of such cash flows works to just about 27% of the cost of land.

It may be noted that in both the scenarios Airport Operator would not be able to recover its cost of land acquisition. Authority needs to ensure that the entire cost of land is reimbursed in terms of net present value over the balance concession period otherwise future land acquisitions for airport purposes could become a major hurdle for airport development.

In view of above, MIAL proposes that Authority should consider the cost of land and reduce the same with the amount amortized each year (as computed under Table (c) of the Annexure 1) 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.

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B) In the matter of Land Development Cost

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In proposal 5.3, Authority has proposed that Land development cost should be added to cost of asset depending on the area of land attributable to an asset.

Attention of the Authority is drawn to the fact that there are certain areas on the airport land where no specific assets are created viz. area left vacant / unused between two or more parallel taxiways, space between apron and the perimeter road, etc. The Authority should consider such scenarios as well and provide a clear guidance on treatment of land Development Cost attributable to such vacant / unused land. Appropriate treatment, in our opinion, of such land development cost could be either by:

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 /2017-18 dated 12th January 2018 "Determination of Useful Life of Airport Assets" and Amendment no.1 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 1 "Useful Life of Assets");

Authority should also clarify that proposal 5.3 is applicable both to Own land as well as Leased land.

Further, Authority should also specify that if there are any specific provisions in the respective concession agreement with an airport operator in this respect, those shall prevail and be honoured by the Authority.

In view of above said, the Authority is urged to consider the submission and responses received from all the stakeholders and thereafter issue a fresh consultation paper, clearly outlining the final proposal and thereafter proceed to issue the final Order in this respect.

Thanking you,

Yours sincerely,

For Mumbai International Airport limited

(Sanjiv Bhargava)

Vice President (Regulatory & Taxation)

Enclosed: Annexure 1

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Mumbai International Airport Limited (MIAL) **Annexure 1**

Particulars	Amount	Cost	WACC %
Debt	200	10.03%	6.72
Equity	100	16%	5.28
WACC			**12.00**

Table (a) FRoR on cost of land

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9
Cost of Land	100	100	100	100	100	100	100	100	100
FRoR @ 12%	12	12	12	12	12	12	12	12	12
NPV of Return	**63.94**								

Table (b) Amortising the historical cost of land

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Year 14	Year 15
Cost of Land (Unamortised)	100	96.67	93.34	90.01	86.68	83.35	80.02	76.69	73.36	70.03	66.7	63.37	60.04	56.71	53.38
Rate of Amortisation (3.33%)	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33
Net cost of land after amortisation	96.67	93.34	90.01	86.68	83.35	80.02	76.69	73.36	70.03	66.7	63.37	60.04	56.71	53.38	50.05
NPV of amortisations	**26.82**														

Particulars	Year 16	Year 17	Year 18	Year 19	Year 20	Year 21	Year 22	Year 23	Year 24	Year 25	Year 26	Year 27	Year 28	Year 29	Year 30
Cost of Land (Unamortised)	50.05	46.72	43.39	40.06	36.73	33.4	30.07	26.74	23.41	20.08	16.75	13.42	10.09	6.76	3.43
Rate of Amortisation (3.33%)	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33
Net cost of land after amortisation	46.72	43.39	40.06	36.73	33.4	30.07	26.74	23.41	20.08	16.75	13.42	10.09	6.76	3.43	0

Table (c) Methodology suggested by MIAL

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Year 14	Year 15
Cost of Land (Unamortised)	100	96.67	93.34	90.01	86.68	83.35	80.02	76.69	73.36	70.03	66.7	63.37	60.04	56.71	53.38
Amortisation (3.33%)	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33
Net cost of land after amortisation	96.67	93.34	90.01	86.68	83.35	80.02	76.69	73.36	70.03	66.7	63.37	60.04	56.71	53.38	50.05
NPV of amortisations (a)	**26.82**														
Return @ WACC on unamortised cost of land	12.00	11.60	11.20	10.80	10.40	10.00	9.60	9.20	8.80	8.40	8.00	7.60	7.20	6.81	6.41
NPV of Returns (b)	**73.17**														

Particulars	Year 16	Year 17	Year 18	Year 19	Year 20	Year 21	Year 22	Year 23	Year 24	Year 25	Year 26	Year 27	Year 28	Year 29	Year 30
Cost of Land (Unamortised)	50.05	46.72	43.39	40.06	36.73	33.4	30.07	26.74	23.41	20.08	16.75	13.42	10.09	6.76	3.43
Amortisation (3.33%)	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33	3.33
Net cost of land after amortisation	46.72	43.39	40.06	36.73	33.4	30.07	26.74	23.41	20.08	16.75	13.42	10.09	6.76	3.43	0.1
NPV of amortisations (a)															
Return @ WACC on unamortised cost of land	6.01	5.61	5.21	4.81	4.41	4.01	3.61	3.21	2.81	2.41	2.01	1.61	1.21	0.81	0.41
NPV of Returns (b)															

NPV of amortisations and return as suggested by MIAL (a+b) **100**

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