

Ref: KIAL/CFO/29/2023-24
Date: 15 December 2023

**Airports Economic Regulatory Authority of India,
AERA Building,
Administrative complex,
Safdarjung Airport,
New Delhi- 110003.**

Kind Attn: Shri Rajan Gupta, Deputy General Manager (Finance)

Dear Sir,

Sub: Submission of comments on Consultation Paper No. 17/2023-24 dated 16 November 2023
Ref: F.No. AERA/20010/MYTP/KIAL/CP-II/2024-28

Kind reference is invited to the Consultation Paper No. 17/2023-24 dated 16-11-2023 in the matter of determination of aeronautical tariffs for Kannur International Airport (CNN) for the second control period beginning from 01.04.2023 to 31.03.2028.

At the outset, we express our sincere gratitude to the Airports Economic Regulatory Authority of India (AERA) for its efforts for finalizing the Consultation Paper of Kannur International Airport operated by Kannur International Airport Limited (KIAL) for the second control period.

As part of the stakeholder consultation process for the referenced consultation paper, we are hereby submitting our comments and views for kind consideration of the Authority.

We would like to emphasize once again the unique challenges that Kannur Airport has faced during the first control period. Given the turbulent times and various externalities surrounding the recovery and growth of the Airport, we humbly request the Authority to kindly consider the same while reviewing our responses and finalizing the order.

- Kannur International Airport commenced its operations on 9 December 2018. Being a greenfield airport, efficient and uninterrupted operations during the initial years is critical to achieve a sustained growth in the future. However, the airport was able to achieve only one year of uninterrupted operations i.e., FY 2020 before the advent of COVID pandemic. The sudden restrictions imposed on air travel severely impacted the ability of airlines to develop and mature the routes in which they operated. While the airport is recovering towards pre-pandemic traffic levels, fact remains that the airport could not operate and stabilize during its first control period which is critical for any greenfield airport.
- Further, it may please be noted that the airport had anticipated that anchor airline partnership will help us to stabilize and achieve growth in operations. However, suspension of flight operations by the anchor airline due to engine supply chain issues (beyond airports control) severely impacted the ability of Kannur airport to recover the passenger traffic to pre pandemic levels.



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Kannur International Airport Limited
CIN:U63033KL2009PLC025103

- Despite the internal challenges faced by airlines, Kannur airport was able to register a traffic of 1.58 million in FY20 which is in line with the projected traffic numbers.
- Lack of PoC status for the airport denied operation by foreign carriers thereby impacting the international operations. Authority is requested to note that this is critical given that the airport was planned to match the competitive environment and hence invested in capex to build an airport with international standards for international airline operations. Investment in CAPEX was made with the expectation that foreign carriers would be operating from Kannur Airport but the same did not materialize contrary to the 'in-principle' approval given by Ministry of Civil Aviation in February 2008.

We request the Authority to kindly consider the background and plans with which the airport and related investments had been envisaged. While airport had taken adequate mitigation measures to control risk, the factors stated above are purely external and beyond the airport's control. In our humble opinion, the evaluation of first control period and projections for the second control period for the greenfield airport such as Kannur Airport should be reviewed with a considerate and unique lens as if the airport is rebuilding operations from the beginning.

Finally, the tariff cards submitted to AERA on 23 November 2023, also clearly shows that KIAL has sincerely considered the suggestions by the authority to provide affordable and sustainable air travel as per the objectives of National Civil Aviation Policy 2016 and Order No. 14/2016-17 by the authority and will be using phased approach for recovery. This shows the Airport's commitment towards its stakeholders and that it is cognizant of the competitive landscape.

Airport has taken several steps as discussed during the submission process, physical meetings and stakeholder presentation to reorganize (given the externalities) and consistently grow towards sustainable operations. Considering above factors, we humbly request the Authority to kindly review and consider our below submissions.

1) Regulatory Asset Base (RAB) proposed by AERA for true-up of the first control period

A. Proposal of AERA:

Para 4.5.6 (ii) of the Consultation paper no. 17/2023-24 for Second control period of KIAL: *"Freehold Land Development Cost – The Authority notes that the AO had claimed Land development costs of ₹ 333.28 Crores towards cutting, filling, blasting etc., on the Freehold land, towards development of various aeronautical assets. The Authority notes that AO has not added such cost to the respective asset in the RAB and instead included the land development cost as a separate asset in the RAB and further claimed depreciation on the same.*

With reference to the above-mentioned Land Development cost, the Authority had taken inference from the relevant provisions of the Order No. 42/2018-19 dated March 5, 2019 of AERA, and notes that the cost has been incurred towards Land Development by AO, prior to the date of issuance of the above-mentioned Order No. 42/2018-19 (i.e., before March 5, 2019). Therefore, the Authority proposes not to consider the above-mentioned



Land Development costs amounting to ₹333.28 Crores, as part of RAB or as part of Land cost (for which Return is provided as per Order No. 42/2018-19) for true up of the First Control Period of KIA.”

Para 4.5.6 (iv) of the Consultation paper no. 17/2023-24 for Second control period of KIAL:
“The Authority notes that the AO has claimed CAPEX of ₹20.14 Crores in FY 2022-23 towards reimbursement of the cost of procurement and installation of ANS equipment incurred by AAI at the airport.”

“The Authority hereby states that tariff for ANS is presently regulated by the Ministry of Civil Aviation. All the assets, expenses and revenues pertaining to ANS are considered separately by the Ministry while determining tariff for ANS services. Further, the tariff for ANS services is determined by the Ministry of Civil Aviation to ensure uniformity across the Airports in the Country. Hence, AERA determines tariff for Aeronautical services of the Airport Operator, by excluding the assets, expenses and revenues from ANS. Based on all the above factors, the Authority proposes not to consider the above-mentioned CAPEX of ₹20.14 Crores as part of RAB.”

Para 4.5.6 (vii) of the Consultation paper no. 17/2023-24 for Second control period of KIAL:
“Based on the above factors, the Authority proposes to consider the FA of ₹289.31 Crores (after excluding FA claimed on Land Development Cost of ₹72.99 crores) claimed by AO as part of RAB.”

B. KIAL’s proposal:

- i. As per para 4.1.6 of AERA order No. 42/2018-19, “The cost of land levelling and land development will be included in the cost of asset if it can be specifically identified with the aeronautical asset and taken to the RAB. In other cases, a return will be given as per this order only on land utilized for Aeronautical purpose as and when used.” The cost incurred to the tune of INR 330 Crore pertains to the land levelling and development carried for constructing aeronautical assets as shown below. The same was shared with the authority vide email dated 18 September 2023. Land Development Cost was considered separately in the financial statements of FY 2018-19 in line with Order No.35/2017-18 issued by the Authority on 12 January 2018 in the matter of Useful Life of Airport Assets, in which it is stated that land development cost of own land to be added to land cost and those of leased land to be amortized over the lease period. Hence, if amortization of land development cost of leased land is permissible as per Order No.35/2017-18, so is depreciation and/or return on land development cost of own land identifiable with specific aeronautical assets, details of which are given in the succeeding para. Note No. 1.3 of Audited Financial Statements of FY 2018-19 may please be referred to for compliance with the Accounting Standards and AERA order. Note No. 2.4 and Note No. 2.5 of Audited Financial Statements of FY 2022-23 also may please be referred to for the above compliances. Hence, the land development costs incurred and identifiable with specific assets may please be considered despite the fact these were considered as a separate line item in RAB. Further, it is only fair to assume and it remains so that land development costs were incurred for development of aeronautical asset irrespective of the



date of Order No.42/2018-19 and therefore we request the Authority to consider the same in RAB and be eligible for return on land development cost.

ii. Given the hilly and uneven terrain on which the airport is located, conducting land development and levelling was unavoidable. Details of the same is as follows:

- Land development for runway, taxiway, isolation bay, turning pads, RESA & RSS as per the original terrain contour varying from 33m to 131 m and to bring the formation levels to the required levels varying from 95m to 102 m.
- Land development done for Apron, HOS road, PTB access area, GSE parking as per the original terrain contour varying from 76m to 103m to bring the formation levels to the required levels varying from 100m to 101m.
- Land development done for approach road, internal service road, operational road and perimeter road as per the original terrain contour varying from 35m to 122m to bring the formation levels to the required levels varying from 37m to 100m
- Land development done for ancillary buildings as per the original terrain contour varying from 60m to 122m to bring the formation levels to the required levels varying from 99m to 102m
- Land development done for boundary wall and operational wall as per the original terrain contour varying from 34m to 140m to bring the formation levels to the required levels varying from 73m to 95m
- Land development done for construction of PTB as per the original terrain contour varying from 85m to 90m to bring the formation levels to the required levels varying from 95m to 102m

Sl No	Location	Quantity (Approx.) in m3	Amount (INR)	% Share
1	Runway	6808564	1,167,668,726	35%
2	Apron	2245825	385,158,988	12%
3	Taxi track	776194	133,117,345	4%
4	Basic Strip	2900380	497,415,170	15%
5	RESA	1068312	183,215,508	6%
6	Over Run	425906	73,042,879	2%
7	Isolation Bay	127943	21,942,225	1%
8	Operational Wall & Operational Roads	595400	102,111,100	3%
9	Emergency Approaches both ends	1219167	209,087,141	6%
10	RSS Fill	566035	453,212,904	14%



Sl No	Location	Quantity (Approx.) in m3	Amount (INR)	% Share
11	Miscellaneous		74,815,818	2%
	TOTAL	16733726.43	3,300,787,803	

- iii. In the KIAL's tariff order for first control period; Order No. 26/2018-19, KIAL had furnished the details of sum estimated to be incurred for 'earthwork, earth cutting filling' in table 4, to the tune of INR 313.69 Cr. The same was approved by the authority. As per actuals, KIAL has incurred similar expenditure for land development.

Table 4: Details of capital expenditure incurred upto and including FY 18-19 as per KIAL (in ₹ crores)

Category	Description	Amount (₹ crores)
Buildings	Civil, Plumbing works etc.	363.22
Buildings	Earthwork, Earth cutting filling	313.69
Buildings	Additional Buildings & Civil Works	102.38
Buildings	Other works - Airside	34.70
Buildings	Ancillary buildings in Operational area	27.07
Buildings	Boundary Wall	9.72
Buildings	Car, Bus and Taxi parking	8.33
Buildings	Watch Tower, Security post	0.62
Buildings Total		859.73

- iv. KIAL observes that the expenditure pertaining to land development has been added as part of RAB in BIAL's tariff order No. 11/2020-21 for the third control period in table 184 under the head 'Site preparation & earth works'. KIAL has followed similar consideration of land development cost.

Table 184: Revised aeronautical asset addition for FY21

S no	Projects	Revised submission of BIAL – total additions	Allocation as per BIAL	Aero addition to FY21 as per BIAL	Revised allocation as per the study	Revised Aero addition to FY21 as per the study	Difference
1	Site preparation & Earthworks	21.98	100.00%	21.98	100.00%	21.98	0.00

KIAL also observes that the expenditure pertaining to land development for runway amounting to INR 775 crore has been approved for BIAL in the third control period.

S NO	Asset	Group Description	Description	Date of Capitalization	Gross block - 2020	Gross block - 2019	Gross block - 2018	Gross block - 2017	Gross block - 2016	Additions - 2020
10744	600000001	Earthwork	Earthwork for NSFR	6-Dec-19	7,751,050,515	0	0	0	0	7,751,050,515



- v. KIAL would also like to highlight the treatment of land development cost for Manohar International Airport, MOPA, Goa in the consultation paper No. 11/2023-24 for the first control period. Authority has proposed land development cost amounting to INR 628.43 Crore and the same has been treated as addition to RAB.

Table 63: CAPEX proposed by the Authority for the First Control Period

		(Rs. in crores)
S.No	Description	Amount
1	Runway, Taxiways and Apron - (Phase I, II & III)	526.17*
2	Passenger Terminal Building including Fit Outs (for 7.7 MPPA) (Phase I, II & III)	1,283.98
3	Airside buildings, Airside roads & Drainage System (Phase I & III)	346.65
4	Site Preparation/ Earthwork	628.43

- vi. In response to authority's view that land development cost being incurred prior to the release of Order No. 42/2018-19, KIAL would like to highlight the land development cost amounting to INR 5.97 Crore approved for Cochin International Airport Limited in the tariff order for third control period. The said cost was capitalized by the airport on 11 March 2017 and the consultation paper for the same was released on 15 June 2021 which is over two years after the date of issuance of Order No. 42/2018-19.

Study on allocation of assets between Aeronautical and Non-Aeronautical assets for CIAL

Unique Identifier	Asset Class	Capitalized on	Description	Useful Life	Acquisition Value	Classification as per CIAL	Revised Allocation	% Aeronautical
12000019810	Buildings & Civil Works	11/03/2017	Plumbing Works	15	112,597,067.89	Common	Common	91.06%
12000019811	Buildings & Civil Works	11/03/2017	METAL FALSE CEILING WORK	20	335,869,379.68	Common	Common	91.06%
12000019812	Buildings & Civil Works	11/03/2017	PMC Metal false ceiling	20	13,646,969.78	Common	Common	91.06%
12000019813	Buildings & Civil Works	11/03/2017	Internal Water Supply	15	3,030,276.03	Common	Common	91.06%
12000019814	Buildings & Civil Works	11/03/2017	Interior works for Reserved Lounges	15	15,285,076.34	Non-Aeronautical	Non-Aeronautical	0%
12000019817	Buildings & Civil Works	11/03/2017	Interior Works	15	232,377,066.97	Common	Common	91.06%
12000019818	Buildings & Civil Works	11/03/2017	PMC Interior Works	15	9,417,178.75	Common	Common	91.06%
12000019819	Buildings & Civil Works	11/03/2017	INTERIOR GLASS PARTITION & DOORS	15	69,513,727.66	Common	Common	91.06%
12000019820	Buildings & Civil Works	11/03/2017	Immigration Counters	10	28,665,269.93	Common	Aeronautical	100%
12000019821	Buildings & Civil Works	11/03/2017	Hand Rails	20	26,548,721.66	Common	Common	91.06%
12000019822	Buildings & Civil Works	11/03/2017	PMC Hand rails	20	1,077,888.90	Common	Common	91.06%
12000019824	Buildings & Civil Works	11/03/2017	Flooring works	15	419,889,938.98	Common	Common	91.06%
12000019825	Buildings & Civil Works	11/03/2017	PMC Flooring	15	19,321,984.81	Common	Common	91.06%
12000019826	Buildings & Civil Works	11/03/2017	FINISHING WORK	15	49,960,150.68	Common	Common	91.06%
12000019827	Buildings & Civil Works	11/03/2017	EXTERIOR FACADE WORKS	20	412,260,302.33	Common	Common	91.06%
12000019828	Buildings & Civil Works	11/03/2017	PMC Facades	20	19,603,373.64	Common	Common	91.06%
12000019829	Buildings & Civil Works	11/03/2017	SAFETY WORK	20	28,708,648.26	Common	Common	91.06%
12000019830	Buildings & Civil Works	11/03/2017	Duty Free Shop	15	22,304,199.05	Non-Aeronautical	Non-Aeronautical	0%
12000019831	Buildings & Civil Works	11/03/2017	Cladding & Finishing works	15	356,213,662.45	Common	Common	91.06%

- vii. In addition to the land development cost, KIAL is also eligible for the financing allowance of INR 72.99 crore associated with the land development cost.
- viii. The land development cost has been incurred solely to develop aeronautical assets. Therefore, the airport has no other option to recover the same from none other than the aeronautical tariffs.
- ix. Considering the responses provided by KIAL which includes detailed bifurcation of land development cost towards specific aeronautical assets, KIAL requests the authority to allow the full expenditure incurred towards land development cost and the associated financing allowance in the RAB for the first control period true up calculation.



- x. Regarding ANS procurement: As per the Greenfield Airports Policy, the CNS/ ATM services will be provided by the central government agency on a cost recovery basis by the airport operator. It says:
- “Clause 6.1 - On any greenfield airport to be developed under these Policy Guidelines, activities relating to Air Traffic Services (ATS), security, customs and immigration would be reserved for central government agencies. Provision of these services would be governed by the policy to be laid down by the Central Government from time to time. Prior to grant of license, an applicant for license shall procure the following clearances:..... b) Air Traffic Services (ATS): Functions related to ATS are being discharged by AAI. The applicant will have to enter into a CNS/ATM Agreement with AAI for the provision of ATS services at the proposed airport. ATS would be provided on a cost recovery basis and AAI would publish a standard agreement for this purpose. The Airport Company would also provide the required infrastructure to AAI free of cost for provision of ATS.”
- xi. KIAL has considered a sum of INR 20.14 Crore as per the details of the bill raised by the ANS service provider dated 20th January 2023. The amount pertains to the cost of procurement and installation of ANS equipment. Hence, it is requested that the amount may be considered as per actuals in view of the invoice raised by Airport Authority of India (AAI).

2) Return on Land proposed by AERA for true-up of the first control period

A. Proposal of AERA:

Para 4.6.3 of the Consultation paper no. 17/2023-24 for Second control period of KIAL: “With respect to AO’s claim towards Return on Land for the First Control Period, the Authority has examined the relevant clauses prescribed in its Order No.42/2018-19, which is as follows:

- As per para 4.1.1 of the aforementioned order, the Authority decides that in case the land is provided to the airport free of cost, no return shall be given on the land.
- As per para 4.1.2, the Authority states that return on land shall be provided on the cost if (provided it is not free of cost) it is used for aeronautical purposes only.
- As per clause 4.1.8. of the aforementioned order, return on land may be allowed on a prospective basis only.

Based on the facts as stated above, the Return on Land should be provided prospectively and not retrospectively (as per clause 4.1.8 of the Order No. 42/ 2018-19), the Authority is of the opinion that the Return on Land should not be included as part of the true up of the First Control Period. Therefore, the Authority proposes not to consider Return on Land claimed by the AO as part of True up of the First Control Period.”

B. KIAL’s proposal:

- i. Land acquisition cost is one of the largest capital expenditures incurred by KIAL in the first control period.



- ii. As per the first control period order for KIAL, decision on return on land to KIAL was proposed post completion of the study undertaken by AERA in this matter.
- iii. At present, 631.4 acres out of the total land of 1192.18 acres, have been utilized for aeronautical purposes. The land acquisition cost for the total land cost of 1192.18 acres is INR 316 Crore. The land cost corresponding to the airport project is therefore considered to be INR 156 Crore and the same has been used to calculate the return on land.
- iv. KIAL also highlights that AERA in its Order No. 42/2018-19 released on 5 March 2019 had laid down the mechanism for calculation of return on land to be provided on cost of land. KIAL has taken into account the mechanism for calculation of return on land as per the order to derive proposed fair return on land, INR 68.29 Cr for true up.
- v. Kannur Airport started its operations in December 2018 due to operational delays. This makes the actual duration of first control period, 4 years and 4 months instead of a full 5 year. In the Consultation Paper No. 11/2023-24 for Manohar International Airport for the first control period, the duration of the first control period is mentioned as 5 years while the 4 months from airport operation start date of Dec 2022 till March 2023 (4 months) is considered as pre-control period. If in case KIAL had considered the duration of first control period as 5 years and the 4 months as pre-control period, the return on land would have been applicable in the first control period itself. Therefore, KIAL humbly requests the authority to not exclude the entire claim on return on land due to a difference of 3 months in the date of capitalization and the Order no. 42/ 2018-19. KIAL requests the authority to accordingly pro rate the return on land for four years in the first control period.

3) Fair Rate of Return (FRoR) proposed by AERA for true-up of the first control period

A. Proposal of AERA:

Para 4.7.1. (ii) of the Consultation paper no. 17/2023-24 for Second control period of KIAL: "The Authority notes that the AO has submitted Cost of Debt as 9.3%, Cost of Equity as 16% and had claimed FRoR as 13.10% for true up of the First Control Period.

The Authority while examining the FRoR submitted by the AO for true up of the First Control Period and has referred to its Decision No. 2b in the Tariff Order No. 26/2018-19 dated November 9, 2018 for the First Control Period, which states that the "FRoR will be trued up based on Actual debt-equity ratio, actual cost of debt and cost of equity which will be decided upon after completion of the proposed study on cost of equity at Major airports". Accordingly, the Authority has taken into consideration the average Cost of Equity derived by the Independent Study report as 15.18%. Further, the independent study reports have used the Capital Asset Pricing Model (CAPM) and a notional gearing (Debt: Equity) ratio of 48:52 to determine the levered Equity beta and accordingly derived the abovementioned Cost of equity as 15.18% and Cost of Debt as 9% (refer para 7.2.7) Based on these factors, the Authority has derived the FRoR as 12.21% and proposes to consider the same for true up of the First Control Period.



B. KIAL's proposal:

- i. COVID-19 pandemic has exposed the vulnerable side of aviation sector and displayed the enormous risk and uncertainty the travel industry faces in case of such events. Its severe impact on the airport financials can be seen not only in the Indian airports but also across the global airports. The pandemic impact on Kannur International Airport was even more severe, as the airport had just commenced its operations in December 2018, and had only one year of uninterrupted operations i.e., FY 2020 before pandemic outbreak.
- ii. KIAL would like to point out that Kannur Airport was at its growing phase and several routes were yet to be mature when the unprecedented pandemic outbreak occurred. The pandemic has increased the risk of airport sector and the same must be accounted by the Authority accordingly in the cost of equity especially for greenfield airports which commenced operations close to pandemic outbreak.
- iii. KIAL also underlines that along with the challenges faced during pandemic, the airport's traffic recovery was significantly affected with impacts of the following events:
 - o Suspension of flight operations and further restricted operations due to capacity restrictions and bubble agreements on international sectors
 - o Grounding of anchor airline has impacted passenger traffic growth
 - o Grounding of aircrafts due to engine supply chain issues
 - o Lack of PoC status which limits any capacity addition
- iv. COVID -19 impacted initial growth, traffic, revenues, and cash flows have severely impacted the profitability of the airport which entails a higher risk profile.
- v. Authority has already approved a cost of equity of 16% for KIAL vide the tariff order No. 26/2018-19 for the first control period.
- vi. Authority proposed 12.21% as FRoR for KIAL, on basis of benchmarking study done with PPP airports including CIAL, MIAL, BIAL, DIAL and GHIAL. However, the benchmark airports are established airports operating in Tier-I cities. Moreover, most of the airports cited by the authority are not greenfield airports. Therefore, the cost of capital for such airports is comparatively lower in the present conditions. Comparing the same with KIAL, which is a greenfield airport may not be a levelled comparison.
- vii. The order on determination fair rate of return as per the independent study done by IIM Bangalore was published on 5 March 2019. The risk-free rate and equity risk premium considered in the IIM Bangalore independent study does not consider the increased risk that the aviation sector is facing post COVID era. The risk profile for greenfield airports have greatly increased. KIAL requests the authority to kindly reconsider the same.
- viii. Moreover, KIAL would like to highlight the following decision by the authority in BIAL's tariff order No. 18/2018-19 for the second control period, para 14.2.4: "*The authority noted that there were no adverse scenarios affecting the risk assessment of BIAL airport, on the contrary, very favorable traffic and profitability had been witnessed for the past 3 years from the time of issue of MYTP-CPI. Considering the past operations, profitability and established traffic base, the authority proposed to consider return on equity at 16% for BIAL for the second control period*". In light of authority's view of the conditions required for a greenfield airport to avail a return of equity of 16%, KIAL



is of the view that Kannur Airport being a greenfield airport operating from a non-metro city under adverse conditions which significantly elevates its risk profile should also be allowed a return of equity 16% cost of equity.

- ix. Similarly, KIAL notes that FRoR allowed for AAI airports is 14% despite of the fact that AAI airports have least risk due to sovereign holding. Whereas the Authority has proposed 12.21% as FRoR for KIAL which has higher equity for financing the development of airport and other capital expenditure. Given the nature of ownership of AAI and KIAL, cost of equity for KIAL is bound to be higher than AAI. However, AERA has adopted a lower cost of equity for KIAL.
- x. Kannur airport has an equity share of 54% and the capital structure of Kannur airport is distinctive with involvement of large number of individuals participating in the equity of the airport. The airport is a unique entity established with equity participation from the Government of Kerala, NRIs, Industrialists, Financial Institutions and Airport Service Providers, with around 9050 shareholders. This can be related to higher cost of equity compared to other airports.
- xi. Similarly, the cost of debt approved by the authority is 9% which is lesser than the actual cost of debt, 9.3% for term loan and 10.3% for funded interest term loan. The details of actual interest rates for the first control period have already been submitted to the authority as shown below:

TERM LOAN (TL)-	INT RATE
CANARA BANK TL-0821773019566	9.30%
SOUTH INDIAN BANK-0721652000000083	9.30%
FEDERAL BANK LTD-10987100005277	9.30%
FUNDED INTEREST TERM LOAN (FITL)-	INT RATE
CANARA BANK TL-0821773019566	10.30%
SOUTH INDIAN BANK-0721652000000083	10.30%
FEDERAL BANK LTD-10987100005277	10.30%

- xii. KIAL requests AERA to consider cost of equity of 16% and cost of debt based on actual figures as shown above considering abovementioned facts and the depth of losses the airport has endured in its inception phase itself.

4) Aeronautical Operation and Maintenance (O&M) expenses proposed by AERA for true-up of the first control period

A. Proposal of AERA:

Para 4.9.5. (i) of the Consultation paper no. 17/2023-24 for Second control period of KIAL: "Employee Expenses- It is noted that the majority of the Headcount included under Security Personnel for the FY 2018- 19, FY 2019-20 and FY 2020-21 pertains to Screener Executives. Therefore, the Authority proposes to consider the actual Headcount of Security Personnel, submitted by the AO for the aforementioned tariff years. However, in the last 2 tariff years, the Headcount of Screeners is much lesser. Further, it is noted that Headcount of Security personnel for the last 2 tariff years are on the higher side when compared with the level of operations, lower traffic growth and the employee numbers of other similar airports. Based on the above



factors, it is proposed to consider 50% of the Security headcount (other than Screeners) for the last 2 tariff years i.e., FY 2021-22 and FY 2022-23.”

Para 4.9.5. (ii) of the Order no. 17/2023-24 for first control period of KIAL: “Rationalization of Power, fuel & water expenses- the Authority proposes to rationalize the Utility expenses (Power, Water etc.), based on the recommendations of the Independent Study report on Efficient O&M expenses of KIA, by considering the expenses of MIA as the base (since its more comparable to KIA) and has derived the proportionate cost of KIA (refer 5.5.3 of O&M Study Report of KIA) on the basis of PAX traffic which works out to ₹ 25.34 Crores (i.e., ₹ 58.41 (Utility expense of MIA/ PAX) x 4.34 MPPA (PAX of Kannur Airport)). The Authority proposes to allow ₹ 25.34 Crores as against ₹ 46.72 Crores claimed by AO and reduce the differential amount of ₹ 21.38 Crores (i.e., ₹ 46.72 Crores minus ₹ 25.34 Crores) over four tariff years starting from FY 2019-20 since the airport commenced its operations and was functional only for approx. four months in the first tariff year, i.e., FY 2018-19.”

Para 4.9.5. (ii) of the Order no. 17/2023-24 for second control period of KIAL: The Authority, based on the recommendations of the Independent Study report on Efficient O&M expenses of KIA, proposes to rationalize the Repairs & Maintenance expenses (other than housekeeping charges) by considering the expenses of MIA as the base (since its more comparable to KIA) and has derived the proportionate cost of KIA based on the PAX traffic, which works out to ₹ 27.61 Crores (i.e., ₹ 63.62 (expense of MIA / PAX Traffic) x 4.34 MPPA (PAX of KIA) . Based on the above factors, the Authority proposed to allow ₹ 27.61 Crores as against ₹ 36.78 Crores claimed by AO and reduce the differential amount of ₹ 9.17 Crores (i.e., ₹ 36.78 Crores minus ₹ 27.61 Crores) over four tariff years starting from FY 2019-20 since the airport commenced its operations and was functional only for approx. four months in the first tariff year, i.e., FY 2018-19 (refer 4.2.3 of O&M Study Report of KIA).

B. KIAL’s proposal:

- i. Regarding headcount of screeners: KIAL would like to highlight that in FY22 and FY23 the designation of Baggage Screening Executives were changed to Junior Managers. However, they perform the same function of baggage screening as seen in the below table. The same can also be verified in the details provided by KIAL vide mail dated 4 July 2023 which contains the name and designation of all the personal in the respective department.

Break up of employees in security department	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Assistant Manager	1	1	1		2
Baggage Screening Executive	18	23	23	8	7



Break up of employees in security department	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Baggage Screening Executive-Trainee	7				1
Chief Security Officer	1	1	1	1	1
Junior Manager	2	2	2	25	21
Junior Executive	1	1	1		
Manager	1	1	1	1	1
TOTAL	31	29	29	35	33

The designation change for the same person can be observed in the detailed employee break up submitted by KIAL to the authority vide email dated 4 July 2023.

- Providing a sample from employee list below:

As per employee break up in FY21:

Emp No	Name of Employee	Designation
0115	AMAL KUMAR K K	Baggage Screening Executive
0116	REMYA K K	Baggage Screening Executive

As per employee break up in FY22:

Emp No	Name of Employee	Designation
0115	AMAL KUMAR K K	Junior Manager
0116	REMYA K K	Junior Manager

It can be observed that the employees are same and only the designations have been changed.

- As a measure to rationalize expenses, KIAL has not undertaken any additional hiring and no increase in manpower is envisaged in second control period also.
- KIAL observes that the Authority has rationalized actual O&M expenses pertaining to power & fuel expenses and repairs & maintenance expenses on basis of benchmarking figures with Mangalore international Airport. We request authority to reconsider the same because of strikingly different nature when compared to the benchmark airport. The airport that has been chosen for comparison with KIAL is a well-established brownfield airport whose variable costs are already spread across a matured traffic flow, while Kannur



Airport is greenfield airport whose cost of operations would be high in the initial years of operations. Furthermore, the challenges faced by the airport such as global pandemic, lack of PoC status and grounding of anchor airline as mentioned earlier has led to a unique situation of low traffic.

- iv. Further, kindly note that Kannur International Airport has been recently constructed with state-of-the-art infrastructure which was supposed to help cater to needs of the ever-changing consumers and growing aviation market and attract Indian and International carriers in extremely competitive catchment area. The terminal area of benchmark airport (Terminal area of MIA is only 39% of the area of KIA; Terminal area of CCJ is only 59% of the area of KIA) are significantly lower than that of Kannur airport.
- v. Authority has highlighted lower traffic during the First Control Period at KIA as a reason to lower power expenses. KIAL would like to point out that lower traffic flow at KIAL, as already mentioned in the document before, was due to factors which were beyond the control of the airport.
- vi. Regular maintenance of assets including utility infrastructure is critical as they wear out with time and use. Neglected or deferred maintenance of infrastructure will result in degradation/ damage leading to maintenance costs over time and in some cases additional capital expenditure. This will further increase the aggregate revenue requirement in the future.
- vii. Kannur International Airport is yet to mature as it commenced its operations in December 2018 and had only one year of uninterrupted operations i.e., FY 2020 before COVID pandemic outbreak.
- viii. During initial years of operation such higher operation and maintenance expenditure is normal and the same matures once traffic increases and stabilizes. KIAL had missed the opportunity for this due to reasons not in control of the airport.
- ix. KIAL humbly requests AERA to consider the operation and maintenance expenses on actuals as submitted by the airport operator.

5) Capital Expenditure (CAPEX), Depreciation and Regulatory Asset Base (RAB) of KIA for the Second Control Period

A. Proposal of AERA:

Para 6.2.2. of the Consultation paper no. 17/2023-24 for Second control period of KIAL: *"The Authority has examined KIA's submission as per MYTP with respect to CAPEX proposed for the Second Control Period. The Authority has grouped the proposed CAPEX for the Second Control Period into the following for evaluation:*

A. Capital additions projects shifted from the First Control Period to the Second Control Period.

B. Capital Addition projects proposed by the AO for the Second Control Period."



Para 6.2.11. of the Consultation paper no. 17/2023-24 for Second control period of KIAL: “The Authority has proposed to consider the capitalization of Aeronautical expenditure for Kannur International Airport for the Second Control Period as ₹ 84.93 Crores.”

Para 6.2.10 of the Consultation paper no. 17/2023-24 for Second control period of KIAL: “Based on the above, the Authority proposes the capital expenditure for the Second Control Period as per the table below:

Table 45: Capital Expenditure (Project-wise) proposed by the Authority for the Second Control Period.”

B. KIAL’s proposal:

- i. The capital expenditure considered in the second control period are solely to ensure compliance with operational, security and safety elements. KIAL has taken necessary steps, in consultation with relevant stakeholders, to minimize the capital expenditure in the next control period. KIAL has included only those inevitable mandatory expenditures related to ensure the safety and security standards of the airport as shown below

Capex heads removed by Authority in CP	KIAL’s comment on the need for CAPEX
Enhancement of Power source (10 to 15 MW)	KIAL is expecting monetization of land assets in the second control period thereby which various new establishments may come at the airport. Therefore, to cater to the power requirement of such new establishments, KIAL is planning to enhance the power source from 10 MW to 15 MW towards the mid of the second control period.
E-Boarding Software	As per the order issued by BCAS, AVEC order no.05/2020, KIAL is required to install E-boarding software at the airport to ensure seamless operation and safety.
Passenger Facilities (enhanced WiFi, Information KIOSK, Passenger App, ChatBot etc)	KIAL plans to invest in improving the passenger experience at the airport such as Enhanced WiFi, Information KIOSK, Passenger App, ChatBot, etc. Measure to enhance customer experience is critical in growth of airport.
Gate Operating System	KIAL plans to invest in gate operating system software to efficiently utilize the data from visual docking guidance system (VDGS). With this software, the data and operational statistics of VDGS may be used at larger scale to improve operational efficiency.



Capex heads removed by Authority in CP	KIAL's comment on the need for CAPEX
Additional CCTV at grey area identified by CISF and Security Dept	CISF team at KIAL has identified multiple grey areas wherein the CCTV coverage is inadequate. This hampers the security and safety at the airport. KIAL plans to procure additional CCTV cameras to address this issue in the second control period. This is critical to ensure safety and security in airport premises and operations.
Biometric AEP System	As part of BCAS guidelines on Design, Implementation, and maintenance of access control system, KIAL is required to install biometric AEP system. KIAL is planning to undertake this installation in the second control period.

- ii. The airport has taken due consideration to avoid any unwanted capital expenditure. Hence KIAL humbly requests authority to kindly consider the expenses as submitted.

6) Fair Rate of Return (FRoR) proposed by AERA for Second Control Period

A. Proposal of AERA:

Para 7.3. of the Consultation paper no. 17/2023-24 for Second control period of KIAL: "Authority's proposals regarding FRoR for the Second Control Period

Based on the materials before it and based on its analysis, the Authority proposes the following:

7.3.1 To consider the Cost of equity at 15.18% as per the CAPM formula.

7.3.2 To consider the notional debt to equity (gearing) ratio of 48%:52% in line with the target gearing ratio being considered in the case of other PPP airports.

7.3.3 To consider the cost of debt of 9% for the Second Control Period,

7.3.4 To consider FRoR of 12.21% for the Second Control Period based on above mentioned Cost of equity, Cost of debt and gearing ratio.

B. KIAL's proposal:

- i. COVID19 pandemic has exposed the vulnerable side of the aviation sector and displayed the enormous risk and uncertainty travel industry faces in case of such events. Its severe impact on the airport financials can be seen not only in the Indian airports but also across the global airports. The pandemic impact on Kannur International Airport was even more severe, as the airport had just commenced its operations in December 2018, and had only one year of uninterrupted operations i.e., FY 2020 before pandemic outbreak.
- ii. KIAL would like to point out that Kannur airport was at its growing phase and several routes were yet to be mature when the unprecedented pandemic outbreak occurred. The pandemic has increased the risk of the airport sector and it has to be accounted by the Authority accordingly in the cost of equity especially for greenfield airports which commenced operations close to pandemic outbreak.



- iii. KIAL also underlines that along with the challenges faced during pandemic, the airport's traffic recovery was significantly affected with impacts of the following events:
 - a. Suspension of flight operations and further restricted operations due to capacity restrictions and bubble agreements on international sectors
 - b. Grounding of anchor airline has impacted passenger traffic growth
 - c. Grounding of aircrafts due to engine supply chain issues
 - d. Lack of PoC status which limits any capacity addition
- iv. COVID -19 impacted initial growth and traffic, thereby affecting the profitability of the airport which entails a higher risk profile.
- v. Authority proposed 12.21% as FRoR for KIAL, on basis of benchmarking study done with PPP airports including CIAL, MIAL, BIAL, DIAL and GHIAL. However, the benchmark airports are established airports operating in Tier-I cities. Moreover, the airports considered are not greenfield airports. Therefore, the cost of capital for such airports is comparatively lower in the present conditions. Comparing the same with KIAL, which is a greenfield airport may not be a levelled comparison. Moreover, KIAL would like to highlight the following decision by the authority in BIAL's tariff order No. 18/2018-19 for the second control period, para 14.2.4: "*The authority noted that there were no adverse scenarios affecting the risk assessment of BIAL airport, on the contrary, very favorable traffic and profitability had been witnessed for the past 3 years from the time of issue of MYTP-CPI. Considering the past operations, profitability and established traffic base, the authority proposed to consider return on equity at 16% for BIAL for the second control period*". In light of authority's view of the conditions required for a greenfield airport to avail a return of equity of 16%, KIAL is of the view that the risk profile of aviation industry has increased when compared to 2018 and Kannur airport being a greenfield airport operating from a non-metro city under adverse conditions which significantly elevates its risk profile should also be allowed a return of equity of 16%.
- vi. The order on determination fair rate of return as per the independent study done by IIM Bangalore was published on 5 March 2019. The risk-free rate and equity risk premium considered in the IIM Bangalore independent study does not consider the increased risk that the aviation sector is facing post covid era. The risk profile for greenfield airports have greatly increased. KIAL requests the authority to kindly reconsider the same.
- vii. Similarly, KIAL notes that FRoR allowed for AAI airports is 14% despite the fact that AAI airports have least risk due to sovereign holding. Whereas the Authority has proposed 12.21% as FRoR for KIAL which has used higher equity for financing the development of airport and other capital expenditure. Given the nature of ownership of AAI and KIAL, cost of equity for KIAL is bound to be higher than AAI. However, AERA has adopted a lower cost of equity for KIAL.
- viii. Kannur airport has equity share of 54% and the capital structure of Kannur airport is distinctive with involvement of large number of individuals participating in the equity of the airport. The airport is a unique entity established with equity participation from the Government of Kerala, NRIs, Industrialists, Financial Institutions and Airport Service



Providers, with around 9050 shareholders. This can be related to higher cost of equity compared to other airports.

- ix. Similarly, the cost of debt approved by the authority is 9% which is lesser than the prevailing cost of debt as of December 2023. At present the actual cost of debt has increased to -10%.

Lender	Interest rate- Term loan	Interest rate- FITL
CANARA BANK	10.15%	11.25%
SOUTH INDIAN BANK	9.2%	10.3%
FEDERAL BANK LTD	10.7%	11.7%

- x. The debt equity ratio of Kannur Airport is 59% : 41% as per audited financial statements of FY 2022-23 and therefore the Airport's challenges as stated under 6 (B) (iii) coupled with lower FRoR considered by the Authority for the second control period will be a huge challenge to achieve the target gearing ratio of other PPP airports in view of continuing airport losses. Hence, KIAL requests AERA to consider cost of equity of 16% and cost of debt based on actual figures considering abovementioned facts and the depth of losses the airport has endured from its inception phase itself

7) Operation and Maintenance (O&M) Expenses proposed by AERA for Second Control Period

A. Proposal of AERA:

Para 9.2.4. of the Consultation paper no. 17/2023-24 for Second control period of KIAL: "The Airport Operator has not projected any growth in the Employee Headcount for the Second Control Period. The AO has considered the Aeronautical Employee Headcount of FY 2022-23 for the entire Second Control Period. Based on the above factors, the Authority has considered the Aeronautical Headcount derived by it for FY 2022-23 (which is 128 as per Table 23) for projecting the Employee Headcount for the Second Control Period."

Para 9.2.16. of the Order no. 17/2023-24 for first control period of KIAL: "Operation & Maintenance Expenses - The Authority is of the view that the runway resurfacing/ recarpeting may be carried out at an interval of 7 to 10 years (as per the practice generally followed in all airports). However, the periodicity depends on various factors such as weather conditions, surface movements, materials used for resurfacing etc. Considering the fact that Kannur is in a heavy rainfall area and the runway has been constructed over high depth of earth filling on undulated hilly surface, there may be chances of secondary and unequal settlement which can deteriorate the runway surface. Although, the runway work was completed in the year 2017, it was put to use only by the end of FY 2018-19. Further, the Authority notes that Kannur International Airport began its commercial operations in December 2018 and soon after, its operations were curtailed due to COVID-19 pandemic, whereby, the runway has not been utilized fully. Also, currently, there seems to be no deterioration in the runway surface. Hence, the Authority proposes not to consider the expenses towards Runway surface maintenance in this Control Period."



B. KIAL's proposal:

- i. KIAL notes that the authority has highlighted concern regarding headcount of screeners vs junior managers and has reduced no. of employees to rationalize manpower and operational & maintenance expenses.
- ii. KIAL point out that, in FY 22 and FY23 baggage screening executives have been promoted to junior manager. However, they perform the same function of baggage screening as mentioned in the response to authority's proposal on the same point in true up of manpower cost for first control period.
- iii. As a measure to rationalize housekeeping and manpower expenses, it can be observed that KIAL has rationalized on any additional hiring in second control period.
- iv. KIAL requests the authority to approve the headcounts as submitted by airport.
- v. As per MYTP submitted by KIAL, runway resurfacing expense has been considered in FY27 and 28. However the authority has proposed to remove the said expense. The runway at airport was constructed in 2018. As per standards, runway recarpeting needs to be done in interval of 7 to 10 years to ensure safe aircraft operations. Further the decision to resurface the runway is not solely based on the operations but also based on the aging of bitumen. Since it is a critical element in ensuring safe operations at the airport, KIAL proposes to conduct a study to assess the wear and tear of the runway asset in FY 27. Based on the same, KIAL shall take the decision to resurface the runway. Therefore, KIAL request authority to approve portion of expense (50%, amounting to estimated INR 25 Crore) for runway recarpeting in FY 28 and the remaining INR 25 Crore shall be incurred by KIAL in FY 29 in the tariff submission for third control period.

8) Non-aeronautical revenue proposed by AERA for Second Control Period

A. Proposal of AERA:

Para 10.2.10. (Table 73) of the Consultation paper no. 17/2023-24 for Second control period of KIAL:

Particulars	FY 24	FY 25	FY 26	FY 27	FY 28	Total
Total Non-aeronautical Revenue	33.39	48.65	54.01	61.49	68.61	266.15

B. KIAL's proposal:

- i. KIAL note that, authority has increased the total non- aeronautical revenue for second control period from INR 230.62 Cr (which can be indicated as INR 190.4 per passenger) to INR 266.15 Cr.
- ii. The total non- aeronautical revenue for first control period is INR 220.9 per passenger. This is due to higher non- aero revenue generated during COVID-19 inflicted years (FY 21 and FY 22) because of COVID-19 tests and medical centers set up at the airport. Such revenue accounted for 56% of the total non-aeronautical revenue for FY22. This is not a consistent revenue stream. The total non-aeronautical revenue for the first control period



after removing the same will amount to only INR 46.5 Crore. During years of uninterrupted operations per pax revenues achieved in FY 20 and FY 23 were -INR 163 and -INR 187 per passenger.

KIA- First control period	FY 19	FY 20	FY 21	FY 22	FY 23	Total
Non- aero revenue in Cr	9.58	25.76	12.85	24.15	23.54	95.88
Total passenger throughput in million	0.22	1.58	0.48	0.8	1.26	4.34
Non- aero revenue per passenger	435.45	163.04	267.71	301.88	186.83	220.92
Remark	Various concessions signed	Uncons trained year	COVID affected year	COVID affected year	Uncons trained year	

- iii. Due to fluctuations in traffic, several non-aero concessions have vacated, and KIAL had to induct new concessioners with revised terms. This resulted in further drop of non-aeronautical revenue.
- iv. In view of above facts, it is evident that the non-aeronautical revenue estimated by KIAL is already on the higher side. Hence, KIAL request authority to consider the time required for the airport to recover the traffic and accordingly consider the non-aeronautical revenue estimates as submitted by KIAL in the MYTP.

9) Return on Land cost proposed by AERA for Second Control Period

A. Proposal of AERA:

Para 13.2.2. of the Consultation paper no. 17/2023-24 for Second control period of KIAL: "As stated in para 4.5.6 (ii), the Authority has proposed not to consider Land Development costs amounting to ₹ 333.28 Crores, as part of RAB or as part of Land cost (for which Return is provided as per Order No. 42/ 2018-19) for true up of the First Control Period of the AO. Accordingly, the land development costs have not been considered for computation of Return on Land for the Second Control Period."

Para 13.2.3. of the Consultation paper no. 17/2023-24 for Second control period of KIAL: "As per Land Return Order No. 42/2018-19 dated March 5, 2019, for Land purchased by airport operating company either from private parties or from government, the compensation will be by way of equated annual installment computed at actual cost of debt or SBI rate plus 2% whichever is lower over a period of 30 years.

The Authority has considered 9.00 % as the cost of debt (refer para 7.2.7) for computing the Return on Land."

B. KIAL's proposal:

- i. Cost of debt proposed for calculating return on land by the authority is 9%. The actual cost of debt currently for KIAL is -10% as opposed to 9% proposed by the authority. The details of prevailing interest rates are as follows:



Lender	Interest rate- Term loan	Interest rate- FITL
CANARA BANK	10.15%	11.25%
SOUTH INDIAN BANK	9.2%	10.3%
FEDERAL BANK LTD	10.7%	11.7%

As seen from the table above, the actual cost of debt for KIAL is significantly higher than the assumed cost of debt.

- ii. As per Order 42/2018-19 para 4.1.4, the cost of debt to be considered for calculation of return on land shall be 'actual cost of debt or SBI base rate plus 2% whichever is lower'. As per the information in SBI website ([Base Rate - Historical Data - Interest Rates \(sbi.co.in\)](http://Base Rate - Historical Data - Interest Rates (sbi.co.in))), the prevailing average base rate in 2023 is 10.10% which is significantly higher than the cost of debt approved by Authority. Moreover, KIAL would also like to highlight that in CIAL's tariff order No. 08/2020-21 for third control period, para 8.2.12, the authority has considered the actual cost of debt for determining the return on land instead of the notional cost of debt. Hence, KIAL request the authority to consider the cost of debt on actuals as submitted by KIAL.

10) Aeronautical revenue for second control period

KIAL's proposal:

- i. KIAL would like to highlight to the authority the loss of revenue due to a delay in finalization of tariff. The tariff order issued by authority for first control period expired in March 2023. KIAL was allowed to continue the existing tariffs vide an interim tariff order issued by the authority. However, this led to lower aeronautical revenue contrary to the revenues it could have obtained in case the tariffs were finalized prior to expiration in March 2023. Since the loss of revenue due to this is high, KIAL humbly requests the authority to consider factoring the same during estimation of aeronautical revenue for FY24 in second control period.

Description	Without tariff increase (INR)	With tariff increase in April 2023 (INR)	Difference (INR)
Aeronautical charges	514,187,253	718,246,614	204,059,362 (40%)

- ii. KIAL also requests the authority to issue the tariff order on an immediate basis as the tariffs proposed by KIAL are unable to meet the ARR. In view of such losses, even a month's early approval would be beneficial for the airport.



It is requested that the Authority arrive at the final Aggregate Revenue Requirement of the third control period after taking into consideration our above submission on the Consultation Paper. This would greatly enable the airport and associated stakeholders in recovery and achieving the growth that was expected.

Soliciting the continued support and co-operation of the Authority,

Thanking you in anticipation,

Yours truly,

For KANNUR INTERNATIONAL AIRPORT LIMITED



JAYAKRISHNAN S
Chief Financial Officer



cc: Shri Ram Krishan,
Director (P & S),
AERA.