Overview of the framework

Need for a framework

Expansion of the airport network is necessary

Accelerated economic growth, aided by expansion of air services in a competitive environment, has manifested itself in a rapid increase in air traffic. The airport sector has witnessed significant interest from both domestic as well as foreign investors following the policy initiatives taken by the Central Government to promote Public Private Partnerships (PPP) in building and operating airports. While the four airports at Delhi, Mumbai, Hyderabad, and Bangalore have already been developed to world-class standards through PPP, the continued inflow of investment has been less than expected. Given the constraints on public resources, future prospects will depend significantly on adoption of a comprehensive policy and regulatory framework necessary for addressing the complexities of PPP, especially for balancing the interests of users and investors. In particular, transformation of rules will have to be accompanied by a change in the institutional mindset.

PPP to ensure lower tariffs and higher quality

Investment requirements for building airport infrastructure will continue to grow, hence private participation would be necessary to supplement public investment. Moreover, private sector efficiencies would help in cutting costs and improving service quality. In particular, private sector participation will help increase non-aeronautical revenues through commercial exploitation of airports. Such revenues will help in cross-subsidising passenger charges that will promote low-cost air travel. PPP in airports would, therefore, ensure lower passenger charges and high quality service.

Managing the expanded airports is a challenge

In addition to PPPs for development and operation of airports, the Government had also initiated a programme for upgrading the airport infrastructure in the public sector. As a part of this initiative, the Airports Authority of India (AAI) had undertaken the redevelopment and expansion of metro airports at Kolkata and Chennai, and at several other non-metro airports across the country. This included development of the terminal buildings and runways for meeting the projected growth over the next decade. After expansion of these airports, the next challenge would be to ensure their management and upkeep at a level commensurate with the high quality of these redeveloped airports. Moreover, there is considerable potential for further development of passenger related amenities that also offer significant revenue streams. PPP in management and development of these airports is, therefore, contemplated.

For sustaining investor interest in operation and management of these airports, coupled with their further development, a precise policy and regulatory framework is being spelt out in this Model Concession Agreement (MCA). This framework addresses the issues which are typically important for limited recourse financing of infrastructure projects, such as mitigation and unbundling of risks; allocation of risks and rewards; symmetry of obligations between the principal parties; precision and predictability of costs and obligations; reduction of transaction costs; force majeure; and termination. It also addresses other important concerns such as user protection, independent monitoring, dispute resolution, transparent and fair procedures; and financial support from the Authority.

The MCA also lays out a structure for city-side development of airports in a planned and phased manner through optimal utilisation of resources on the one hand and adoption of international best practices on the other. The objective is to secure value for public money and provide efficient and cost-effective services to the users.

Structure of the Concession

Commercial development has significant potential

For operation, management and development of the airport and city side development, the proposed framework contained in this MCA provides for: (a) operation and management of the airport including the commercial exploitation of specified areas, and (b) city side development in the form of hotels, convention centres and airport related businesses on the land identified for city side development.

World-class standards to be ensured

The proposed structure seeks to ensure that the airports are maintained and operated to world-class standards while the commercial potential of each airport is maximised. The Concessionaire would also be responsible for undertaking all future expansion of the airport. This is being stipulated as an obligation of the Concessionaire because the existing assets would need to be augmented by the Concessionaire in order to cater to increased traffic volumes without compromising on the level of service to the Users.

The master plan of the airport is to be included as part of the concession agreement and should specify the land use and other restrictions on development of the airport. It must also earmark the vacant lands for future expansion of the airport.

Airport revenues to meet costs of operation, management and development

The Concessionaire is expected to meet the expenditure relating to operation, management and development of the airport from revenues that it would generate from User Fees, commercial activities and city side development. This would provide a mechanism for optimising on the overall operations of the airport while reducing the costs to the public exchequer and the user.

Elements of financial viability

The four critical elements that determine the financial viability of an airport are the concession period; traffic volumes; user fees and other revenues; and costs. The concession period for such projects which require significant capital infusion over time is normally in the range of 50 to 60 years. Such a timeframe should enable a robust project structure and any further extension in the concession period would improve financial viability only marginally as the present value of projected revenues after 50 years would be very low from the Concessionaire's perspective. Passenger volumes can be estimated with a reasonable level of certainty based on the existing volumes which are expected to rise gradually over time. The user fees would have to be maintained at affordable levels so that the users are not unduly burdened. Additional revenues can, however, be generated from non-aeronautical sources and city side development to enable some cross-subsidisation of user fees.

Reduction in costs is the key element

Three of the four parameters stated above could be virtually taken as given, and as a result, cost is the variable that will determine the financial viability of an airport project. The MCA, therefore, lays down economical and efficient standards that would optimise on capital costs and avoid wasteful expenditure. The MCA also contains several provisions that would incentivise the Concessionaire to economise on operational costs without compromising on performance standards. The envisaged capital expenditure has also been phased out over a period of five years to improve the project viability. The Concessionaire is expected to maximise its non-aeronautical revenues in order to cross-subsidise the User Fees. However, where the potential for non-aeronautical and city side revenues is inadequate, bidders may seek an appropriate capital grant from the Authority in order to reduce their investment for arriving at an acceptable rate of return.

Financial viability is critical

Technical parameters

Unlike the normal practice of focussing on construction specifications, the technical parameters proposed in the MCA are based mainly on output specifications, as these have a direct bearing on the level of service for users. Only the core requirements of design, construction, operation and maintenance of the airport are to be specified and enough room would be left for the Concessionaire to innovate and add value.

In sum, the framework focuses on the 'what' rather than the 'how' in relation to the delivery of services by the Concessionaire. This would provide the requisite flexibility to the Concessionaire in evolving and adopting cost-effective designs and processes without compromising on the quality of service for users. Cost efficiencies would occur because the shift to output-based specifications would provide the private sector with a greater opportunity to innovate and optimise on designs and processes in a way normally denied to it under conventional input-based procurement specifications.

Performance standards

Performance standards to be enforced

For an airport project, the Concessionaire would not only procure the civil works and equipment required during the concession period from time to time, it would also provide various passenger and cargo related services. The efficiency of its operations would normally be reflected in the quality of service provided to the users. The MCA, therefore, identifies the key performance indicators relating to operation of the aeronautical assets, terminal building, cargo terminal etc., and specifies penalties for failure to achieve the requisite levels of performance, especially in relation to user services.

The MCA includes a Passenger Charter that the Concessionaire should publish and implement for the benefit of users of the airport. This will add to the accountability of the Concessionaire to the users.

Concession period

Concession period to be sufficiently long

The concession period should normally be long enough to enable the Concessionaire to recover its investment with a reasonable rate of return. In the case of a brownfield airport, the traffic increase may be gradual and the investments in airport infrastructure as well as city side may take long to recover. As such, a total concession period of 50 to 60 years has been provided. This would enable the Concessionaire to realise the full potential of the project and thus offer a competitive bid. A shorter concession period would lead to a lower revenue share or require a greater capital grant.

Selection of Concessionaire

Competitive bidding on single parameter will be the norm

Selection of the Concessionaire will be based on open competitive bidding. All project parameters such as the concession period, user fees, price indexation, city side development and technical parameters are to be clearly stated upfront, and pre-qualified or short-listed bidders will be required to specify the revenue share that they are willing to offer to the Authority in the form of a Premium. The bidder who offers the highest Premium should win the contract. In exceptional cases where instead of offering a Premium, the bidders may seek a capital grant from the Authority, the bidder who seeks the lowest grant would win the concession.

Concession fee

Revenue share to be the bid parameter

PPP projects in several sectors rely on revenue sharing between the Concessionaire and the Authority as the basis of bidding. This is so because the revenues would be largely regulated, and specifying their precise treatment and computation would not pose difficulties. Further, the manner and quantum of collection of such revenues would be amenable to effective monitoring.

Concession fee should be levied when revenue streams can sustain it

The minimum concession fee will be a fixed sum of Re.1 per annum for the concession period. The Concessionaire shall, commencing from the 15th year of the concession period, pay a Premium equal to 1 per cent of the total realisable fee which shall be increased every year by an additional 1 per cent of the total realisable fee. Where bidders do not seek any grant and are willing to offer a higher revenue share to the Authority and/or an earlier commencement of its payment, they will be free to do so, subject to a ceiling of 50 per cent of the total realisable fee. In case of an exceptionally viable project, the bidders would be free to offer annual payment in the form of city side premium which shall be in addition to the 50 per cent revenue share mentioned above.

The rationale for the above fee structure is that in the initial years, debt service obligations would entail substantial outflows. Over the years, however, the Concessionaire will have an increasing surplus in its hands on account of the declining debt service on the one hand and rising revenues on the other. Recognising this cash flow pattern, the concession fee to be paid by the Concessionaire will be based on an ascending revenue-share.

Revenue share to be compared with reference to regulated fees

The bidder is expected to take into consideration all revenues accruing from regulated operations, commercial activities and city-side development. However, the revenue share will be computed as a percentage of the total regulated fee for airport operations only. By way of illustration, a bidder may estimate the revenues from regulated fees in a year to be Rs. 100 crore and that from other activities to be Rs. 75 crore. Thus, its total revenues from the airport would be Rs. 175 crore. In the event it wishes to offer Rs. 10 crore to the Authority as the concession fee, it would do so by offering a revenue share of 10 per cent, which shall be computed as a percentage of revenues from regulated fee. In other words, unregulated revenues shall not be reckoned while determining the revenue share though the Concessionaire will factor the same while making its offer.

Grant

It is proposed that based on competitive bidding, the Authority may provide a capital grant of up to a maximum of 30 per cent of the project cost in case the airport is not financially viable. This would help in bridging the viability gap of the project. Where even such assistance is inadequate for making a project financially viable, an additional grant not exceeding 10 per cent of the project costs may be provided for O&M support during the period following the commissioning of the Mandatory Works.

O&M Support

In case the net revenues expected from the project are not sufficient to s
the concession, the bidders will be free to seek, at the bidding stage, an
support in the form of an annual grant from the Authority to enable th
perform their obligations under the Agreement.

Risk allocation

Risk allocation and mitigation are critical to private investment

As an underlying principle, risks have been allocated to the parties that are best able to manage them. Project risks have, therefore, been assigned to the private sector to the extent it is capable of managing them. The transfer of such risks and responsibilities to the private sector would increase the scope of innovation leading to efficiencies in costs and services.

The commercial and technical risks relating to construction, operation and management are being allocated to the Concessionaire, as it is best suited to manage them. Other commercial risks such as the rate of growth of traffic have also been allocated to the Concessionaire. On the other hand, all direct and indirect political risks are being assigned to the Authority.

It is generally recognised that economic growth will have a direct influence on the growth of traffic and that the Concessionaire cannot in any manner influence the rate of economic growth. By way of risk mitigation, the MCA provides for extension of the concession period in the event of a lower than expected growth in traffic. Conversely, the concession period is proposed to be reduced if the traffic growth exceeds the expected level.

The MCA provides for a target traffic growth and stipulates an increase of upto 20 per cent in the concession period if the growth in traffic is less than projected. For example, a shortfall of 8 per cent in the target traffic will lead to extension of the concession period by 12 per cent. On the other hand, a reduction of up to 10 per cent of the concession period is stipulated in the event of a higher than expected growth. For example, an increase of 8 per cent in the target traffic will reduce the concession period by 8 per cent.

Financial close

Unlike other agreements for infrastructure projects which neither define a time-frame for achieving financial close, nor specify the penal consequences for failure to do so, the MCA stipulates achievement of financial close in respect of debt equivalent to at least 40 per cent of the Total Project Cost. Since the development works are to be undertaken over an extended period of five years, financial close for debt equivalent to 40 per cent of Total Project Cost has been stipulated.

User Fee

A precise mechanism for determination of User Fee has been specified for the entire concession period since this would be of fundamental importance in estimating the revenue streams of the project and, therefore, its viability. The User Fee shall be based on the rates notified for the airport by the Authority prior to bidding for the concession.

User Fees should be determined with care and precision

The MCA provides for an annual reduction in the User Fee by about 2 per cent to account for the depreciation in assets and lower level of service to the users due to increased congestion. The MCA provides for indexation of the tariffs to the extent of 100 per cent thereof linked to the Price Index. In respect of non-aeronautical services, however, the Concessionaire shall be free to determine the charges thereof.

Development of the airport

Handing over possession of at least 90 percent of the required land is proposed as condition precedent to be satisfied by the Authority before financial close.

The MCA defines the scope of the project as well as the mandatory works with precision in order to enable the Concessionaire to determine its costs and obligations. Additional works not included in the scope of the concession may be undertaken, but only if the entire cost thereof is borne by the Authority or passed on to the users in the form of fees.

Operation and maintenance

Operation and maintenance of the airport is proposed to be governed by strict standards with a view to ensuring a high level of service for the users, and any violations thereof would attract stiff penalties. In sum, operational performance would be the most important test of service delivery.

Service quality and safety must be ensured

The MCA provides for an elaborate and dynamic mechanism to evaluate and upgrade safety requirements on a continuing basis. The MCA also provides for traffic regulation, security and rescue operations.

Reserved services

Certain services at the airport are to be provided by the designated government agencies. The MCA specifies the obligations of the Concessionaire in respect of the reserved services with a view to ensuring that the respective agencies are enabled to provide such services without any hindrance or lack of support from the Concessionaire.

Right of substitution

Lenders will have the right of substitution

The project assets may not constitute adequate security for lenders. It is the project revenue streams that constitute the mainstay of their security. Lenders would, therefore, require assignment and substitution rights so that the concession can be transferred to another company in the event of failure of the Concessionaire to operate the project successfully. The MCA accordingly provides for such substitution rights.

Force majeure

Concessionaire will be protected against political actions

The MCA contains the requisite provisions for dealing with force majeure events. In particular, it affords protection to the Concessionaire against political actions that may have a material adverse effect on the project. The MCA also provides for relief to the Concessionaire upon occurrence of an unforeseen event.

Termination

In the event of termination, the MCA provides for a compulsory buy-out by the Authority, as neither the Concessionaire nor the lenders can use the airport in any other manner for recovering their investments.

Pre-determined termination payments should provide predictability

Termination payments have been quantified precisely as compared to the complex formulations in most agreements relating to infrastructure projects. Political force majeure and defaults by the Authority are proposed to qualify for adequate compensatory payments to the Concessionaire and will thus guard against any discriminatory or arbitrary action by the Authority. Such termination payment shall not be less than the product of twenty four and the Realisable Fee due and payable for and in respect of the last month of the Concession Period. Further, the project debt would be fully protected by the Authority in the event of termination, except for three situations, namely, (a) when termination occurs as a result of default by the Concessionaire, 90 per cent of the debt will be protected, (b) in the event of non-political force majeure such as Act of God (normally covered by insurance), 90 per cent of the debt not covered by insurance cover will be protected; and (c) when termination occurs on account of Concessionaire Default during Development Period, the initial expenditure equal to 40 per cent of the Total Project Cost will be set apart, and for the expenditure in excess of such 40 per cent, an amount equal to 90 per cent of the debt expended will be protected.

A different method of valuation has been adopted for city side development, which will enable a more transparent and predictable valuation of assets in the event of termination.

Monitoring and supervision

A credible and fair arrangement for supervision is essential

Day-to-day interaction between the Authority and the Concessionaire has been kept to the bare minimum by following a 'hands-off' approach, and the Authority shall be entitled to intervene only in the event of default. Checks and balances have, however, been provided for ensuring full accountability of the Concessionaire.

Monitoring and supervision of construction, operation and maintenance is proposed to be undertaken through an Independent Engineer (a qualified firm) that will be selected by the Authority through a transparent process. Its independence would provide added comfort to all stakeholders, besides improving the efficiency of project implementation. If required, a public sector consulting firm may discharge the functions of the Independent Engineer.

The MCA provides for a transparent procedure to ensure selection of well-reputed statutory auditors, as they would play a critical role in ensuring financial discipline. As a safeguard, the MCA also provides for appointment of additional or concurrent auditors.

To provide enhanced security to the lenders and greater stability to the project operations, all financial inflows and outflows of the project are proposed to be routed through an escrow account.

Support and guarantees by the Authority

Support and guarantees by the Authority are essential

By way of comfort to the lenders, loan assistance from the Authority has been stipulated for supporting debt service obligations in the event of a revenue shortfall resulting from political force majeure or default by the Authority. Guarantees and/ or compensation have also been provided to protect the Concessionaire, though for a limited period, from construction of competing airport which can upset the revenue streams of the project.

City side development

City side development can cross-subsidise user fees

Capital subsidies alone may not suffice in ensuring the financial viability of the Project. It may, therefore, be necessary to provide development rights over real estate for generating additional revenue streams with a view to making the Project self-sustaining. It is expected that revenues from city side development will also cross-subsidise the Project operations and help reduce the burden on the users as well as the exchequer. This would also help in an integrated development of the Project as well as the neighbourhood areas.

While allowing sufficient flexibility to the Concessionaire for exploitation of the earmarked land and spaces, the MCA stipulates some limits and restrictions to prevent excessive commercialisation of the real estate. The MCA also enables the Concessionaire to grant licences to third parties for the use of the real estate which would have to revert to the Government at the end of the concession period.

Funded Works

Certain works may be financed by the Authority

The MCA provides an option that enables the Authority to finance selected works, thus relieving the Concessionaire from the obligation to raise the requisite financial resources for such works. This provision can be used for capital-intensive works which cannot be sustained by User Fee. This arrangement can also be adopted for other project-specific reasons.

The MCA provides for fixing a lump sum amount for construction of Funded Works, which would be paid to the Concessionaire in four equal instalments. The MCA also provides for a mobilisation advance of upto 20 per cent of the aforesaid lump sum amount in order to facilitate the Concessionaire in meeting the construction costs of Funded Works.

Interests of Employees

The MCA provides for safeguarding the interests of the employees of the Authority who are currently deployed at the airport. The employees would continue to remain in the employment of the Authority and Concessionaire shall reimburse the emoluments of all such employees to the Authority. Such employees will be able to exercise the option of working for the Concessionaire on deputation and shall be entitled to receive their normal monthly emoluments along with a deputation allowance. The employee will be free to revert to the Authority after a period of 90 days from COD. The Concessionaire shall also be free to repatriate to the Authority the services of not more than 20 per cent of the employees at any time prior to the 5th anniversary of COD.

Miscellaneous

A regular traffic census and annual survey has been stipulated for keeping track of traffic growth. Sample checks by the Authority have also been provided for. As a safeguard against siphoning of real estate revenues by the Concessionaire, a floor level in premium of city side development, if any, has also been stipulated.

The MCA addresses other important issues such as dispute resolution, suspension of rights, change in law, insurance, defects liability, indemnity, redressal of public grievances and disclosure of project documents.

An effective dispute resolution mechanism is critical

Conclusion

Together with the Schedules, the proposed framework addresses the issues that are likely to arise in operation, management and development of brownfield airport projects on Operate, Manage and Transfer basis. The proposed regulatory and policy framework contained in the MCA is critical for attracting private participation with improved efficiencies and reduced costs, necessary for accelerating growth.

Private participation should improve efficiencies and reduce costs