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June 2, 2018

**The Secretary  
Airports Economic Regulatory Authority of India  
AERA Building, Administrative Office  
Safdarjung Airport  
New Delhi-110 003.**

Dear Madam,

Sub: Consultation Paper No.04/2018-19 Dated 08-05-2018 – Reg.

Kind reference is invited to the Consultation paper No.04/2018-19 dated 08-05-2018 in the matter of determination of Fair Rate of Return (FRoR) to be provided on the cost of land incurred by the various airport operators in India.

We appreciate the attempt of the Authority for resolving one important matter kept in abeyance since the introduction of new regulatory regime for major Indian airports. Especially in the case of Cochin and Chandigarh airports, regulatory approach for treatment of land was not clear while determining the aeronautical tariffs. However we would appreciate that keeping aside this matter, the tariff order of Cochin Airport was finalized and implemented the tariff revisions with a rider that return on land cost will be decided after conduct of a proper study.

The report of the study thus conducted and the proposed solutions are now made available by the Authority and we were also given an opportunity of being heard in the stakeholder's consultation meeting process held on 30-06-2018. We are extremely grateful to the Authority for hearing our views and the assurance given that, before finalizing the order, our views also will be taken into consideration.

In this regard, we would now like to offer our written submissions on the consultation paper with specific thrust on the study report published by the authority, as the regulatory approach outlined is drawn strongly on the recommendations developed by the study report.



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The study report casts doubt as to the fact that impact of this important issue on airport Industry has been thoroughly looked into or not, hence we would like to bring to your notice certain fundamental flaws we observed in the study conducted by the consultant and certain inconsistencies noticed in the proposal given by the Authority on the matter.

1. Not aligned with the price cap regulation frame for Indian airport regulations:

Consequent upon the introduction of AERA Act, Authority had made extensive studies on the type of regulation to be implemented in Indian Airport Industry. Finally, it was arrived at price cap regulation, which is a function of capital expenditures, fair rate of returns and revenues. The land being the major capital expenditure to be incurred by one category of airports, any incorrect assessment can distort the investments heavily. Therefore while regulator offers a fair rate of return to other components of capital expenditures, there is no justification to exclude one class of capital expenditure namely land, from entitlement of any sort of returns is against the letter and spirit of the price cap regulation itself.

2. Improper benchmarking of practices within and outside the industry in India and abroad:

While conducting the study, Consultants have benchmarked the practices in the Power Sector, NHAI and also internationally Auckland and some other airports. However, these industries and the airports are not regulated under price cap regulation and also don't have any similarity in practices, such as methodology of tariff computation, ownership pattern, till frame works, rate of return, bank rates, models of land ownership etc. The study could have considered the airports across the world, which have adopted price cap regulation with hybrid till and their treatment on land cost and returns to it.

3. Not offering any returns on cost of land:

As per the proposed scheme, the FRoR is given on the RAB and also depreciation is offered as a pass through cost. In the proposed scheme no Fair rate of return (FRoR) on land is not offered. The only proposal is to amortise the land cost for a period of 30 years' period and reimburse the actual costs. This essentially means, the investor who is investing their money in the land asset will not receive any return hereafter. This will have far reaching consequences in the future of airport investments, ultimately leading to sub optimal airport capacity and poor airport service quality levels.

Investment in class of assets other than Land		
Investment Amount	Crore	1
Useful Life Fixed Asset	Years	30
Fror	%	11.17%
Depreciation	1.0	
Return	1.6	
<b>Total Addition to ARR</b>	<b>2.6</b>	
PV Terms	1.1	

Investment in Land		
	<b>Amortization - 30 years</b>	
Land	Crore	1
Amortization Period		30.00
Investment recovered through Amortization	1.0	
Total Addition to ARR	1.0	
Present value Terms	0.3	

4. Offers negative return to the investors:

The proposal though stated to be meant to offer fair rate of return to investors actually only proposed to offer reimbursement of actual cost of land through amortizing it over a period of 30 years, which essentially means there will be returns hereafter but reimbursement of actual cost of land only will be given, that too, it will be returned over a period of 30 years without reckoning the time value of money. In fact, if we consider the time value of money, the



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proposal offers negative return to investors. The below table indicates the would happen to an investor who invests in land assets and gets it reimbursement over a period of 30 years.

	Amortization - 30 years	
Land	Crore	1
Amortization Period		30.00
Investment recovered through Amortization	1.0	
Total Addition to ARR	1.0	
Present value Terms	0.3	

5. Time value of money has not been factored:

In the entire scheme, the time value of money is not considered. If an investor puts his money in other classes of assets, which is amortized/depreciated with the useful life of 30 years, the aggregate revenue return along with depreciation, the refund will be 2.6 times of the original cost (at discounting rate of 11.6%) and the present value of the ARR will be 1.1. As against it, the present value of the proposed methodology of reimbursement of cost is only 0.3. That is the investor who puts in money in two classes of aeronautical assets, the land asset will offer a minus return in terms of the present value and rest classes of assets will offer 1.1 times.

The following two table indicates the result of investment made in two class of assets by the airport investor under the existing price cap regulation

Investment in land asset		
	Amortization - 30 years	
Land	Crore	1
Amortization Period	#	30.00
Investment recovered through Amortization	1.0	
Total Addition to ARR	1.0	
PV Terms	0.3	

Investment in Fixed Assets other than land		
Investment Amount	Crore	1
Useful Life Fixed Asset	Years	30
Fror	%	11.17%
Depreciation	1.0	
Return	1.6	
Total Addition to ARR	2.6	
Present value Terms	1.1	

The above table indicates that the principle of proportionality is defeated with in the regulatory framework in existence

6. Discrimination between airports in respect of treatment of land:

If an airport does not purchase land and hold it in the Balance Sheet, but the acquisition is made by the Government and leases it to the airport operator, the entire lease expenses will be a pass through cost in the hands of the airport operator. Perhaps, after the first lease period, the same land can be leased out to another airport operator at revised lease rentals, then also, the airport operator will be entitled to get lease rentals, which can obtain lease rentals in perpetuity. However, if an airport operator purchased the land in its own and hold it and includes it in the Balance Sheet, those category of airport operator will not be entitled to any form of returns not even lease rentals. This is again discriminating same class of investment under various ownership/models of airport operators.

7. Not addressing the adverse impact on future land acquisitions: At present, no new instances of land acquisition by the Government is happening at the required pace in the country for airport development. The future model of airport development in India will be the Greenfield Airport, in which, the airport operators themselves have to acquire the land at the higher land acquisition costs stipulated in the amended Land acquisition Act. Under that scenario no international or domestic investors will put in their investment into the class of assets, which offers negative return. Consequently, the one successful model of implementation of airport in India is going to be wiped out, unless other suitable financing format is found out. As on date, no other financing option except equity and borrowed finance is there.

8. Not addressing the repayment ability on Principal and interest on borrowed fund for land acquisition:

If the airport operator borrows funds from the bank, they need to be serviced with principle and interest. The present formula does not have the ability on servicing of interest. Moreover, even the servicing of the principle amount suffers from the cash flow mismatches. Usually the banks/financial institutions lends for a period of 12-15 years, whereas, the proposal suggests for amortization of land acquisition with in a period of 30 years, which leads to mismatching in the cash flow unless an alternative mechanism is found out.

Land funded through Borrowings-Funding mismatch		
Loan Amount		
Land	Crore	1
Interest Rate		8.90%
Moratorium		1
Loan Tenure		13
Principal Repayment	1.0	
Interest	0.6	
<b>Total Repayment</b>	<b>1.6</b>	
<b>Total Repayment PV</b>	<b>1.0</b>	

As against the above, the proposal offers the following.

	Investment in land asset	
	Amortization - 30 years	
Land	Crore	<b>1</b>
Amortization Period	#	<b>30.00</b>
Investment recovered through Amortization	<b>1.0</b>	
Total Addition to ARR	<b>1.0</b>	
PV Terms	<b>0.3</b>	

9. Offers inferior returns to equity investors: The cost on equity offered by the regulator to the airport operator itself is inferior to other sectorial returns to their cost on equity. Under that scenario, offering nil return or negative return to this major chunk of project cost in the form of land cost will further deteriorate the overall return and attractiveness to invest and remain invested in the airport sector.
10. Not offering any alternate solution for financing of land acquisition by the private airport operators:

Some airport operators are offered with land acquired by Governments and lease rentals are levied. Perhaps, the net present value of all the instalments of lease rentals if equated with the cost of acquisition using discounting rate at weighted average cost of capital would better resolve the reimbursement of cost of land in present value terms. However, there again, no return to the Government is offered.. However, Government can afford to it considering the overall economic benefit an airport brings in to the economy. On the contrary, offering one class of airports, who in fact takes land acquisition related risks in its own, with an inferior or nil return is highly inequitable. A deeper analysis may indicate that the Government can offer the same land in perpetuity with lease rentals under the Government land acquisition route, but under the other options, no return has been offered stating a reason that return will have to be have offered in perpetuity to airport operators. There are inconsistencies and arbitrariness in this approaches.



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11. Incorrect depiction of fact about CIAL:

The Consultancy Paper vide Table-2 under para 2.1.3 indicates various types of land arrangement for airport development. Under that head, the airports are classified into four types and Cochin International Airport has been bracketed under the category that 'acquired land was provided to the airport operator through transfer in value against equity', which is not a correct statement/categorization.

CIAL acquired the land at the then prevailing market rates. The land of CIAL was acquired by a society in the name of Kochi International Airport Society (KIAS), for which the entire funding was made available by CIAL. The entire cost of the land, administrative expenses, rehabilitation expenses, providing direct and indirect employments to evictees were borne by CIAL and later KIAS has transferred the ownership of the land to CIAL through a conveyance deed. The State Government has incurred no cost or expenditure towards the land acquisition of CIAL. Later, the Government of Kerala has invested in the equity share capital of CIAL, which was not in the form of land but in cash terms.

Therefore, the categorization of CIAL under the fourth category of type of land arrangement in the consultation paper is wrong. We would suggest to include a fifth category in the consultation paper as well as in the final order, where the entire land was acquired by the airport operator themselves, clearly distinguishing the features of this type of airport, which are going to be the primary parties affecting the decisions on determination of FRoR to be provided on the cost of land. Rest of the type of airports have their own separate features and will not be adversely affected to the extent of the fifth category of airports mooted.





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2. Terms of Reference of study were not addressed: There as seven Terms of References of the land study conducted. However, none of the terms of reference were properly addressed in the report given by the consultant.

Sl. No.	Terms of Reference	Consultant's report status
a)	Reviewing and analyzing different modes of acquisition of land in case of existing major airports across India and Internationally. (2.1)	Not covered adequately.
b)	Analyzing the FRoR to be provided on the land (2.2)	Not covered adequately.
c)	Treatment of land cost and returns (2.3)	Not covered adequately.
d)	Possible modes of providing FRoR on land cost (2.4)	Not covered adequately.
e)	Practices followed by the State Governments in allocating land for the development of projects (2.5)	Not covered adequately.
f)	As the land is an asset which is never depreciated, quantify the impact on RAB if return is provided infinitely (2.6)	Not covered adequately.
g)	Once the airport is built, it may not be probable that the airport gets closed and land is sold. Thus, the increase in the value of land may not be realized.	Not covered adequately. Operational area land or portion of operational area land cannot be sold.

13. Solution offered is not on the Terms of Reference of the matter: Taking into consideration the above factors, it can be concluded that the study has not properly looked into the various aspects extensively with its Terms of Reference and hence a lopsided one ,hence requested to reject the report.

In this back ground, we would request that a proper study may be conduct on the matter by looking into other significant factors missed out in the process. In the meantime, we would like to request that if the Authority is proceeding with issue or final orders following suggestions may be reckoned .

1. FRoR may also be provided on land at par with other class of aeronautical assets which forms part of RAB with an appropriate useful life, that can be determined by the AERA.

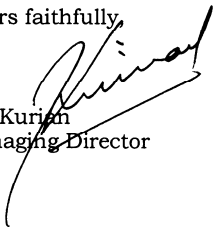


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2. If admissible, the amortization cost also be made part of the pass through revenue expenditure.
  
3. In case a FRoR cannot be offered and insertion of land cost in to the RAB is not acceptable, a pre-funding mechanism in the form of ADF may be awarded to the airport operator, as attracting equity investment and loan financing for acquisition of land will be a difficult proposition.
  
4. In case, point No.1, 2 and 3 is not acceptable, offer appropriate and comparable lease rentals in perpetuity with annual inflation adjustment.

Thanking you,

Yours faithfully,

  
V J Kurian  
Managing Director