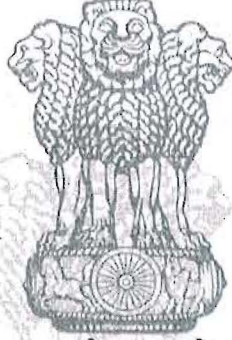


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Order No. 42/ 2018-19



सत्यमेव जयते

Airports Economic Regulatory Authority of India

**In the matter of Determination of Fair Rate of Return (FRoR) to be provided on
Cost of Land incurred by various Airport Operators in India**

05th March, 2019

भा.वि.आ.वि.प्रा.

**AERA Building
Administrative Complex**

Safdarjung Airport

New Delhi – 110 003



TABLE OF CONTENTS

1. LIST OF ABBREVIATIONS	3
2. INTRODUCTION	4
3. CONSULTANTS REPORT AND STAKEHOLDER CONSULTATIONS	6
4. AUTHORITY' S DECISIONS	11
5. ORDER	13



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1. LIST OF ABBREVIATIONS

AAI	Airport Authority of India	GAL	GMR Airports Limited
AERA Act	Airports Economic Regulatory Authority Act, 2008	GOI	Government of India
AERA or the Authority	Airports Economic Regulatory Authority	HPCL	Hindustan Petroleum Corporation Limited
BAOA	Business Aircraft Operators Association	IATA	International Air Transport Association
BIAL	Bengaluru International Airport Limited	IOCL	Indian Oil Corporation Limited
BPCL	Bharat Petroleum Corporation Limited	ISP	Independent Service Providers
CHIAL	Chandigarh International Airport Limited	KIAL	Kannur International Airport Limited
CIAL	Cochin International Airport Limited	Land Study	The Land Study report prepared by EY
CP	Consultation Paper	MIAL	Mumbai International Airport Limited
EMI	Equated Monthly Installment	NCAP	National Civil Aviation Policy, 2016
EY	Ernst & Young	O&M	Operating and Maintenance
FIA	Federation of Indian Airlines	RAB	Regulatory Asset Base
FRoR	Fair Rate of Return	SBI	State Bank of India
		WACC	Weighted Average Cost of Capital



2. INTRODUCTION

- 2.1 One of the major challenges in the development of airports is the acquisition of land for airport construction. Be it greenfield airports or expansion of existing ones, the acquisition of adequate land could prove to be a major hurdle for the airport operator and the government. The land is often required in urban areas where the value of the lands is high and fairly large tracts of land are required to construct an airport. The agency that wants to acquire lands for airport development has to therefore invest substantial funds and plan the process of acquisition well in advance.
- 2.2 In the past, the State Governments were required to provide the land free of cost to the Airport Authority of India (AAI) for construction of airports. Even the new National Civil Aviation Policy 2016 (NCAP) of the Government of India (GOI) requires the State Governments to provide land free of cost for airport development in the smaller towns. But with the privatization and commercialization of airports, the State Governments are reluctant to provide valuable lands free of cost for airport development. In some cases, land has been provided on lease basis. And some of the State Governments want the land cost incurred by them to be part of the equity of the airport operator for strategic reasons or to get higher returns in the form of dividends and by way of appreciation in the value of shares. In some cases, airport operators have bought lands or they plan to purchase land at market rates from private landowners for future expansion of the airport.
- 2.3 When the land is provided free of cost by the State Governments, there is no need to provide any return on the land to the airport operating company. The new airports in Hyderabad and Bengaluru were developed with greater emphasis on privatization and commercialization and the State Governments of Andhra Pradesh and Karnataka respectively provided the land on lease basis to the private party chosen to build and operate the airport. The model adopted for calculating the lease rent is such that it is nominal in the initial years when the airports struggle to achieve commercial viability and it increases in the later years when the airport starts earning profits. Airports Economic Regulatory Authority of India (AERA or the Authority) has treated the lease rentals as operating and maintenance (O&M) costs while determining the tariff for these two airports.
- 2.4 In the case of Kochi, the airport operator had to purchase the land from the State Government at a cost. The government then used the money to acquire shares in the company formed to develop and operate the airport. In the Consultation Paper for determination of tariffs for the first control period (2011-2016), AERA took a light touch approach towards tariff determination and therefore did not take a view on the treatment to be given to the cost of land purchased by the operator. The Authority extended the existing tariffs on the ground that the control period was nearly over. In the tariff determination for the second control period the Authority took the view that a decision on providing a return on land would be taken up after conducting a study of the issues involved. A similar view was taken in the case of Chandigarh airport where the governments of Punjab and Haryana had



provided the land for the development of the airport and treated the cost of land as a part of their equity in the company which was formed for the development and operation of the airport. Some of the airport operators like Cochin International Airport Limited (CIAL) and Kannur International Airport Limited (KIAL) are likely to purchase additional land required for the expansion of the airport.

- 2.5 In such a changing scenario, the Authority realized that a detailed study needs to be made to finalise the methodology to be adopted for reimbursing the land cost to the airport operating company. The objective of the study was to arrive at a methodology to be adopted by the Authority that would enable the government and the airport operating company to acquire lands for construction of new airports and for expansion of existing airports in a timely manner without leading to a steep increase in aeronautical tariff.



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3. CONSULTANTS REPORT AND STAKEHOLDER CONSULTATIONS

3.1 The study was entrusted to Ernst and Young (EY) and based on the report submitted by them, the Authority put up a consultation paper dated 8th May 2018 and invited the views and suggestions of the stakeholders. A meeting of the stakeholders was also held on 30th May 2018 to discuss the issue. The stakeholders were also asked to submit their written representations. Based on what emerged in the discussions and the issues raised in the written representations, the Authority put out a supplemental consultation paper firming up its proposals and invited further comments from the stakeholders. A list of the stakeholders is annexed. The issues raised by them have been discussed in the relevant sections of the analysis made by the Authority. This order of the Authority takes in to account the report of the consultants, the views expressed by the stakeholders in the consultation papers, the written representations of the stakeholders and the examination by the authority of their views and suggestions.

3.2 The Authority's analysis of these issues is given below.

3.3 Land provided free of cost

3.3.1 Wherever land has been provided free of cost by the government to airport operating company, the Authority shall not provide a return on the land to the airport operator.

3.4 Lease rentals

3.4.1 In cases where land has been provided to the operator on lease, the lease rent shall be reimbursed to the operator as a part of the O&M expenses. Federation of Indian Airlines (FIA) requested the Authority to clarify the mechanism for fixation of lease rentals and opined that lease rent charged should be nominal keeping in view the interests of the passengers. FIA has also suggested that the land value should be amortized over the extended period of the concession wherever the right to extend the tenure of the concession rests with the airport operator. The Authority has considered this suggestion and is of the view that the lease rent should be reasonable. It would not be proper to determine rents over different tenures. Besides, amortization over long periods of time will not provide adequate incentive for the agency responsible for acquiring the land. The Authority therefore favours the view that land rent should not exceed the amortized value of the land over 30 years. Besides wherever lease rentals have been already agreed upon as a part of the concession, the Authority would take them into consideration while determining tariff and provide for them in the O&M costs as has been done in the past.

3.4.2 Some of the stakeholders like Indian Oil Corporation Limited (IOCL) and Bharat Petroleum Corporation Limited (BPCL) have suggested that the Authority should fix the lease rentals charged by the airport operators. They are of the



view that the rentals are exorbitant and the ultimate customer has to bear the costs. Though this is not the subject matter of this study, the Authority would examine the reasonableness of land rentals charged by the airport operator when the tariff determination for the Independent Service Providers (ISPs) is taken up.

3.5 Cost of land

- 3.5.1 The Authority had suggested in the consultation paper that the cost of land will be subject to due diligence and that a return will be provided only on the fair value of the land. Mumbai International Airport Limited (MIAL) has indicated that this will lead to regulatory uncertainty and actual land cost should be taken. GMR Airports Limited (GAL) has put forth the view that the return should be provided on the actual land cost since it varies from state to state and depends on various factors such as location, timing etc. FIA has pointed out that the Authority had not spelt out the definition of fair value of land in the consultation paper.
- 3.5.2 The Authority is of the view that it should do a due diligence on all costs incurred by the airport operator. It would not be proper to take the actual cost of purchase of land without assessing its reasonableness since the Authority is mandated to consider only reasonable costs. Providing returns on actual costs could also lead to purchase of lands at higher costs since the operator and the procuring agency would like to get higher returns. The Authority would therefore consider the circle rates or guideline values for the land fixed by the government and the statutory requirements in the fixation of land costs while assessing the reasonableness of the land costs. Wherever the Authority feels it necessary, it may also commission a study to determine the cost of land for regulatory purposes. However, where land has already been purchased from the Government and the land cost has been agreed upon by the airport operating company and the government, the actual cost of the land will be taken into consideration by the Authority.
- 3.5.3 The Authority is mandated to determine only aeronautical charges and therefore had proposed that only lands that need to be set apart statutorily and land on which aeronautical assets are constructed would be considered for providing a return. Some of the stakeholders representing the airports were of the opinion that the entire land set apart for aeronautical purposes should be considered since a part of the lands may be required for future expansion. The Authority only considers capitalised assets for providing a return and on the same analogy would consider only the value of lands put to use by the airport operating company. As and when additional lands are put to use, their value would be considered.



3.5.4 FIA and International Air Transport Association (IATA) were of the view that Single Till policy should be adopted and all the revenue from non-aeronautical leases should subsidise the aeronautical charges. The Authority is not inclined to make any changes to its Till policy at present.

3.6 Cost of resettlement and rehabilitation incurred in land acquisition

3.6.1 The costs relating to resettlement and rehabilitation of persons from whom land is acquired can be quite substantial in urban areas. GAL and MIAL were of the view that the cost of rehabilitation and resettlement of displaced persons should be included in the land value. Normally when a State Government acquires lands for public purposes, it includes the cost of resettlement and rehabilitation of the displaced persons in the cost of land transferred to the airport operating company. When the airport operating company has to bear the costs on rehabilitation and resettlement, such costs will be taken into RAB, only if the State Government is involved in the process. This will be applicable only on lands purchased after this order.

3.7 Cost of development of land.

3.7.1 The cost of land levelling and strengthening has been quite high in Bengaluru and it is likely to be even higher in the case of Navi Mumbai airport. These are essential costs and need to be provided for so that the funds invested in such works are recovered. Wherever the land on which a specific aeronautical asset is constructed can be identified, the land development costs will be added on to the cost of the asset and it will be taken to the Regulatory Asset Base (RAB). Land development costs incurred on lands mandated to be maintained will be added to the land costs and dealt with as per this order. And land costs/cost of development incurred on lands used for non-aeronautical purposes will ~~be~~ not be given any return.

3.8 Cityside development

3.8.1 The airline associations, IATA and FIA and some of the public representatives in Bengaluru were of the view that the airport operators do not commercially exploit the land earmarked for city side development or they delay the exploitation of such land leading to lower subsidisation from non-aero revenue resulting in higher aeronautical charges. In such cases, they were of the view that the Authority should assume a notional revenue from such unexploited land and subsidise the aeronautical charges to that extent. The Authority has examined this suggestion and it is of the view that city side development is important. However, it is the airport operator who stands to lose more if city side lands are not monetised since the operator can retain 70% of such revenue. Besides with so many constraints on land development, the operator has limited options when it comes to city side land development. Many of the activities may



not be very remunerative too. The government also has a role to play since it has an interest in the development of the city and may like the operator to take up certain activities. If the master plan for city side development can be agreed upon with timelines then the Authority could ask the airport operator to go by the schedule and if necessary impose penalties for non-adherence to the schedule. In most cases there is no master plan and it will not be prudent on the part of the Authority to impose any penalties based on certain assumptions on how and when city side lands should be developed.

3.9 Land held as equity by the government

3.9.1 The Authority in its consultation paper took the view that in case land is provided by government as equity in the airport operating company by the government, then it is entitled to the lease rent by way of amortisation of the land cost after deducting any dividend paid on its shares. This was based on the premise that the government gets higher income from the development of the airport by way of professional tax on employees, higher taxes on transactions in immovable properties in the area adjoining the airport and from overall development of the area. The government could also benefit by way of higher share value for the equity it holds. Therefore the Authority has been of the view that the dividend paid to the government should be deducted from the lease rent payable and only this amount will be taken as cost for tariff determination.

3.9.2 GAL has pointed out that there are two transactions in such cases. Sale of land by the government and issue of shares by the company to the government. The land has been acquired by the airport operator from its funds and therefore the airport operator should be provided the return on the investment by amortising the land value at Weighted Average Cost of Capital (WACC) rate over a period of thirty years or the period of the concession. MIAL has pointed out that the proposal of the Authority is arbitrary and will lead to uncertainty over how the land costs are to be amortised. CIAL and Chandigarh International Airport Limited (CHIAL) have also suggested a similar treatment of land costs in such cases.

3.9.3 If there is a sale as suggested, the airport operating company gets valuable free hold land which it can dispose off at the end of the concession. In such a scenario, the appreciation in land value accrues to the airport operating company. Normally such lands are not disposed off since they form part of aeronautical assets such as runway, taxiway, and navigational aids and so on. Besides, the government usually imposes conditions restricting the airport operating company from selling the land which implies that the company can only operate the assets so long as it exists or has a right to the concession. In



this case also the appreciation in the value of the land is reflected in the value of the shares of the company. Therefore, both the government and the airport operating company benefit by the appreciation in land value which accrues mainly because of the airport operations. Therefore, in the opinion of the Authority, it would not be proper to give a return on the land costs based on the weighted average cost of capital. Besides this would amount to taking the land value into the RAB which is not justified since land is a non-depreciable asset. The approach of the Authority lays greater emphasis on the premise that the investment in land needs to be recovered over a reasonable period of time. However, a reasonable return needs to be provided on the investment in the land by the airport operating company. The Authority is therefore of the view that such transactions may be dealt with in the same manner as proposed for purchase of land by airport operating company.

3.10 Purchase of land by the airport company

3.10.1 The Authority had proposed that when the airport operating company purchases land from private parties the land cost will be recovered in the form of Equated Monthly Instalments (EMI) over a thirty-year period with a return worked out at the cost of debt. The objective is to keep the costs down but at the same time give a reasonable return to the investor. CIAL, GAL and MIAL had represented that the return should be given as in the case of any regulatory asset on basis of the WACC instead of the interest rate. They have pointed out that the funds invested consist of both equity and debt and therefore it wouldn't be proper to give a return at the cost of debt alone.

3.10.2 The Authority notes that the WACC varies depending on the debt equity ratio and some of the more profitable companies that have larger general reserves have a much higher that would enable them to get a higher return on the land than other companies that are not so profitable. One way out of such a situation is to prescribe a normative debt equity ratio of say 80:20 and work out the WACC. Such an approach would be based on certain assumptions on what should be the ideal debt equity ratio for the sector. The Authority would rather prefer an approach that emphasises the need to return the cost of land rather than give a return on the investment in line with other assets. This is based on the view that a full return as in the case of other assets may not be possible due to the adverse impact on the tariffs. The Authority prefers to provide a return as proposed in the consultation paper by way of equated annual instalments over 30 years at the cost of debt or State Bank of India's (SBI) lending rate plus 2% whichever is less.



4. AUTHORITY'S DECISIONS

4.1 In the light of the above discussions and analysis, the Authority takes the following decisions:

4.1.1 In case land is provided free of cost, then no return shall be given on the land.

4.1.2 The return will be given only on the cost of land used for aeronautical activities.

4.1.3 In the case of land given on lease, the lease rent will be allowed as pass through expenditure wherever it is found reasonable. The Authority shall consider a lease rent calculated by amortisation of land cost over a period of 30 years as reasonable. Wherever lease rents have been agreed upon by the government and the airport operating company, the arrangement will be honoured subject to reasonableness.

4.1.4 In case land is purchased by the airport operating company either from private parties or from government, the compensation shall be in the form of equated annual instalments computed at actual cost of debt or SBI base rate plus 2% whichever is lower over a period of thirty years. The equated annual instalment is to be calculated as per the following formula.

$$\text{Equated Annual instalment} = [\text{Cost} \times \text{Rate} (1+\text{Rate}) ^ 30] / [(1+\text{Rate}) ^ 30 - 1]$$

where,

Cost: Actual cost of Land

Rate: Actual cost of debt or SBI base rate plus 2% whichever is lower

4.1.5 The cost of land will be subject to due diligence. The Authority shall take into consideration the guideline value or circle rates fixed by the government and the statutory requirements in fixing land value while acquiring lands by government and any other factors that may be relevant in arriving at the reasonable cost of land. In the case of lands acquired in the past, the recorded value will be taken into consideration.

4.1.6 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.

4.1.7 The cost of resettlement and rehabilitation of persons from whom land was purchased will be added to the cost of land after due diligence by the Authority.



- 4.1.8 This order of the Authority will take effect from the next control period.
- 4.1.9 These decisions shall be added to the guidelines of the Authority for determination of tariffs for airport operators.



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5. ORDER

In exercise of powers conferred by Section 13(1) (a) of the AERA Act, 2008, the Authority hereby determines Fair Rate of Return (FRoR) to be provided on Cost of Land incurred by various Airport Operators in India as detailed in its **decision in section 4**. This order shall be incorporated and read as a part of the guidelines for tariff determination for Airport Operators issued by the Authority vide its Order no. 13/2010-11 dated 12.01.2011.

By the Order of and in the Name of the Authority




(Geetha Sahu)
AGM (F)

To

All Airport Operators at Major Airports (as per list attached).

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Copy to:-

Secretary, Ministry of Civil Aviation, Rajiv Gandhi Bhawan, New Delhi – 110003 – For information



LIST OF AIRPORT OPERATORS AT MAJOR AIRPORTS

1. **Dr. Guru Prasad Mahopatra, IAS,**
Chairman,
Airports Authority of India,
Rajiv Gandhi Bhawan, Safdarjung Airport,
New Delhi 110 003.
2. **Shri V.J. Kurian, IAS,**
Managing Director,
Cochin International Airport Pvt. Ltd. (CIAL),
Ndedumbassery, Kochi Airport P.O.,
Ernakulam – 683 111, Kerala.
3. **Shri Rajeev Jain,**
Chief Executive Officer,
Mumbai International Airport Ltd (MIAL),
CSI Airport, 1st floor Terminal 1B,
Santacruz (E), Mumbai- 400 059.
4. **Shri Videh Kumar Jaipuria,**
Chief Executive Officer,
Delhi International Airport Pvt. Ltd. (DIAL),
New Udan Bhawan, Opp. Terminal 3,
IGI Airport, New Delhi – 110 037.
5. **Shri S.G.K Kishore,**
Chief Executive Officer,
GMR Hyderabad International Airport Pvt. Ltd. (HIAL),
GMR Aero Towers, 4th Floor,
Rajiv Gandhi International Airport,
Shamshabad, Hyderabad – 500 409.
6. **Shri Hari K Marar,**
Executive Director & President,
Bangalore International Airport Pvt. Ltd. (BIAL),
Alpha-2, Administration Block,
Bengaluru International Airport,
Devanahalli, Bangalore – 560 300.
7. **Shri Sunil Dutt,**
Chief Executive Officer,
Chandigarh International Airport Ltd.
New Civil Air Terminal Village,
Jureri, Mohali – 140306, Punjab.
8. **Shri Suresh Kakani,**
Chairman and Managing Director,
MIHAN India Ltd.,
DBAI Airport, Nagpur- 440 005.
9. **Shri V Thulasidas**
Managing Director,
Kannur International Airport Limited,
Karaperavoor, Mattannur – 670702.
Kerala.

