

Overview of the framework

Need for a framework

The airport sector in India is witnessing significant interest from both domestic as well as foreign investors following the policy initiatives taken by the Government of India to promote Public Private Partnerships (PPPs) in building and operating airports. While the four metro airports at Delhi, Mumbai, Hyderabad and Bangalore are already being developed to world class standards through PPP, the continued inflow of investment will depend on a comprehensive policy and regulatory framework necessary for addressing the complexities of PPPs, and for balancing the interests of users and investors. Moreover, the transformation of rules must be accompanied by a change in the institutional mindset.

In addition to PPPs for development and operation of airports, the Government has initiated a programme for upgrading airport infrastructure in the public sector. As a part of this initiative, the Airports Authority of India (AAI) is undertaking the redevelopment and expansion of metro airports at Kolkata and Chennai, and at 35 non-metro airports across the country. This includes development of the terminal buildings to world class standards for meeting the projected growth over the next decade. After these terminal buildings are re-developed, the next challenge would be to ensure their management and upkeep at a level commensurate with the high quality of these terminals. Moreover, there is considerable potential for development of car parks, cargo facilities, hotels and other passenger related amenities that offer significant revenue streams.

For sustaining investor interest in city side development of airports, 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

Managing the new terminals is a challenge

A comprehensive framework is a pre-requisite for PPP

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 and financial support from the Government. The objectives is to secure value for public money and provide efficient and cost-effective services to the users.

Structure of the Project

City side development has significant potential

For management and upkeep of the terminal buildings and other city side development at non metro airports, the proposed framework contained in this MCA provides for: (a) operation and maintenance of the terminal building including the commercial exploitation of specified spaces; (b) development and operation of the car park and cargo facilities; and (c) real estate development in the form of hotels, convention centres and related businesses on the land identified for commercial use.

The proposed structure seeks to ensure that the terminals developed by AAI are maintained to world-class standards while the commercial potential of each airport is maximised.

The Master Plan for each airport should earmark and allocate the land for various aeronautical and non-aeronautical assets, including future expansion. Phased airport development has been envisaged in order to enhance project viability.

The Authority would undertake all future expansion of aeronautical assets, including the terminal building. This is being stipulated as an obligation of the Authority because these assets have been built by the Authority and their expansion would be better handled by the Authority. On the other hand, the Concessionaire would be responsible for the phased development of real estate, cargo facilities and car park.

User charges can be cross-subsidised

The Concessionaire is expected to cross-subsidise the expenditure relating to maintenance of the terminal building from the revenues that it would generate from its non-aeronautical activities. 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.

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 at 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 in a way normally denied to it under conventional input-based procurement specifications.

Technical parameters will focus on the level of service for the users

Performance standards

For an airport project, the Concessionaire would not only procure the civil works and equipment, it would also provide various passenger related services as well as cargo handling. 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.

Performance standards to be enforced

Concession period

Since the scope of the project includes operation and maintenance of the terminal building, a concession period beyond 30 years is not considered appropriate. The Authority may, therefore, fix the term between 20 and 30 years.

Concession period to be specified

Further, since the investment of the Concessionaire is primarily in real estate development which does not have a direct bearing on airport operations, the MCA stipulates that the Authority may consider providing a longer concession period for real estate development.

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 and technical parameters are to be clearly stated upfront, and short-listed bidders will be required to specify only the amount of annual concession fee they are willing to offer to the Authority. The bidder who offers the highest concession fee should win the contract. In exceptional cases, instead of offering a concession fee, bidders may seek financial support for meeting their obligations. In such cases, the bidder seeking the lowest support should win the contract.

Concession Fee

Concession fee to be paid by the Concessionaire to the Authority would be determined by competitive bidding. The concession fee payable in the first year would be the bid value and for each subsequent year, it would increase at the rate specified in the MCA.

Fixed concession fee 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. In this case, however, the revenues would be largely unregulated, and specifying their precise treatment and computation could pose constant difficulties. Moreover, the manner and quantum of collection of such revenues may not be amenable to effective monitoring. Thus, a fixed annual concession fee is the preferred arrangement.

O&M Support

Grant for unviable projects

In case the net revenues expected from the project are not sufficient to sustain the concession, the bidders will be free to seek,

at the bidding stage, an O&M support in the form of an annual grant from the Authority to enable them to perform their obligations under the Agreement.

Risk allocation

As an underlying principle, risks have been allocated to the parties best suited 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.

Risk allocation and mitigation is critical to private investment

The commercial and technical risks relating to construction, operation and maintenance 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, are also being allocated to the Concessionaire. On the other hand, all direct and indirect political risks are being assigned to the Authority.

User fee

All aeronautical charges would continue to be levied and collected by the Authority. The Concessionaire would be permitted to levy and collect the user fees relating to cargo facilities, car parking and entry to the terminal building. The fee would be levied in accordance with the Fee Notification to be issued prior to bidding for the contract so as to enable the Concessionaire to determine its revenue streams.

Fee should be determined with care and precision

Construction

Handing over possession of at least 90 percent of the required land is proposed as a condition precedent to be satisfied by the Authority before the commercial operation date.

The MCA defines the scope of the project with precision and predictability in order to enable the Concessionaire to determine its costs. The Authority may require the Concessionaire to undertake additional works within a specified limit, but only if the entire cost

Scope of project to be defined precisely

thereof is borne by the Authority. The scope and extent of construction relating to real estate development would be determined by the Concessionaire in accordance with the applicable laws.

Operation and maintenance

Maintenance standards shall be enforced strictly

Operation and maintenance of the terminal building and other segments of the airport are 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.

While allowing sufficient flexibility to the Concessionaire with respect to exploitation of commercial space at the airport, the MCA stipulates some limits and restrictions to prevent excessive commercialisation.

Passenger Charter to be published

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

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, police assistance, emergency medical services and rescue operations.

Real estate development

Airports tend to become a hub of activity relating to travel and tourism. This includes opportunities to build hotels, convention centres and other tourism related assets. Real estate development, therefore, constitutes the other major component of the concession. The MCA provides sufficient flexibility to the Concessionaire for undertaking these activities on the land earmarked for this purpose and in conformity with applicable laws.

Right of substitution

Lenders will have the right of substitution

In the airport sector, project assets may not constitute adequate security for lenders. It is mainly the revenue streams of the project 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

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.

Concessionaire will be protected against political actions

Termination

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

Termination payments have been quantified precisely as compared to the complex formulations in most agreements relating to private infrastructure projects. Political force majeure and defaults by the Authority would qualify for adequate compensatory payments to the Concessionaire with a view to providing safeguards against any discriminatory or arbitrary action by the Government or the Authority. Further, the project debt would be fully protected by the Authority in the event of termination, except for two situations, namely, (a) when termination occurs as a result of default by the Concessionaire, 90 per cent of the debt will be protected, and (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 will be protected. However, the Concessionaire will not be entitled to any termination payment in case it fails to commission the project on account of its own default.

Pre-determined termination payments should provide predictability

A different method of valuation has been adopted for the real estate. It relies on pre-determined principles that will enable a more

transparent and predictable valuation of real estate in the event of termination.

Monitoring and supervision

Independent 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 a material default. Checks and balances have, however, been provided for ensuring full accountability of the Concessionaire.

Since the Authority continues to be responsible for undertaking the air side activities, the MCA clearly delineates the roles and obligations of the Concessionaire and the Authority.

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 stipulates a fair and transparent process for 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.

Miscellaneous

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.

Conclusion

Together with the Schedules, the proposed contractual framework addresses the issues that are likely to arise in financing of the city side development of the non metro airports. Adoption of the proposed regulatory and policy framework contained in the MCA is a pre-requisite for attracting private investment based on improved efficiencies and reduced costs, which are necessary for accelerating growth.

Private participation should improve efficiencies and reduce costs