

F. No. AERA/20010/AAI-UDF/2009-10
Consultation Paper 05/2009-10



Airports Economic Regulatory Authority of India

**Proposal of AAI to levy User
Development Fee at Trivandrum
International Airport**

**Rajiv Gandhi Bhawan
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26th March, 2010

Subject: TO CONSIDER THE PROPOSAL OF AAI TO LEVY USER DEVELOPMENT FEE (UDF) AT TRIVANDRUM AIRPORT.

The Airports Authority of India (AAI), is a body constituted under the Airports Authority of India Act, 1994. AAI manages 128 airports including Civil Enclaves. AAI also provides air navigation services over the Indian airspace covering an area of 2.8 million square nautical miles of land mass and the adjoining oceanic area.

2. Trivandrum International Airport is one of the airports owned and managed by the AAI. The actual annual passenger throughput at this airport during 2008-09 was 19,54,882, which is in excess of 1.5 million passengers per annum (mppa). Hence, Trivandrum International Airport is a 'major airport' as defined in clause (i) of Section 2 of the Airports Economic Regulatory Authority of India Act, 2008 ('the Act'). As per 2008-09 traffic statistics, the international passengers comprised 75.39% of the total passenger throughput. Further, in terms of Sec 13 (1) (b) of the Act, Authority shall, inter alia, determine the amount of development fees in respect of major airports. Furthermore, Rule 89 of the Aircraft Rules, 1937, provides that the licensee (of an aerodrome) may levy and collect at a major airport the User Development Fee at such rates as may be determined under clause (b) of sub-section (1) of Section 13 of the Act.

3.1 AAI has made an application on 24.12.2009 to the Authority seeking levy of User Development Fee (UDF), at Trivandrum International Airport in view of the construction of the New International Terminal Building (NITB) thereat. As has been indicated subsequently, Authority examined this proposal and had series of consultations with AAI. It has been stated that with the saturation of the existing international terminal building and with no scope for expansion at its present location due to site constraints, AAI has constructed the NITB (towards Chakai canal side) that will cater to 800 departing and 800 arriving passengers at a time. The existing terminal area of 9000 sq. mtr. would increase to 32000 sq. mtr. after the commissioning of NITB. The project was approved by the Central Government, at an estimated cost of Rs.245.58 crores, vide letter AV.24018/1/1999-VB dated 3rd October, 2006 (**Annexure-I**). Further, AAI vide their additional submission dated 22.03.2010, stated that the completion cost of the project is estimated at Rs.289.60 crores (**Annexure II**). It, inter alia, includes the cost of aerobridges, apron, taxi link, car park and approach road. AAI have stated that the Internal Rate of Return (IRR) and the Economic Rate of Return (ERR) of the project, calculated as per Government guidelines, works out to -0.71% and 0.24%, respectively. Pursuant to several discussions and exchange of correspondence, the AAI made final submissions, in respect of the proposal, containing requisite details vide letter No.AAI/CHQ/REV/AERA/09 dated 19.03.2010 (**Annexure-III**).

3.2 AAI has submitted that the NITB is likely to be commissioned during March-April, 2010 and in order to make the project viable and to attain a

reasonable rate of return the levy of UDF is imperative. AAI has proposed to levy and collect UDF @ Rs.550/-per embarking domestic passenger and @ Rs. 1020/- per embarking international passenger, on an ad-hoc basis, for a period of 10 years effective April, 2010. Alternately, a levy @ Rs.280/- per embarking domestic passenger and @ Rs. 715/- per embarking international passenger has been proposed, on an ad-hoc basis, for a 15 year period.

3.3 Further, AAI has vide letter No.AAI/CHQ/REV/AERA/10 dated 22.03.2010, stated that the NITB is complete and that it would like to operationalise the same at the earliest. It has been requested that *“levy of UDF at Trivandrum Airport may be approved so that the levy may coincide with the commissioning of the terminal.”*

4.1 The Authority is, presently, in the process of finalizing its regulatory philosophy and approach in economic regulation of airports and air navigation services. In this connection, a Consultation Paper (No.03/2009-10) has been issued on 26.02.2010 wherein the Authority has set out its tentative positions on various issues before it, including in respect of levy of UDF. In view of the submission of AAI, the Authority proposes to proceed with ad-hoc determination of UDF pending tariff determination in the first cycle.

4.2 Rule 89 of the Aircraft Rules, 1937 reads as under:
User Development Fee – The licensee may

(a) Levy and collect at a major airport the User Development Fees at such rate as may be determined under clause (b) of sub-section (1) of section 13 of the Airports Economic Regulatory Authority of India Act, 2008;

(b) levy and collect at any other airport the User Development Fees at such rate as the Central Government may specify.

However, no methodology has been prescribed in the Aircraft Rules for determining the UDF. The Concession Agreements for Bangalore International Airport Ltd (BIAL) and Hyderabad International Airport Ltd (HIAL) provide for levy of UDF “from embarking domestic and international passengers, for the provision of passenger amenities, services and facilities” and for the UDF to be “used for the development, management, maintenance, operation and expansion of the facilities at the Airport”. The draft guidelines issued by the Ministry of Civil Aviation noted that levy of UDF was to be considered only in cases and years where the target revenue of a major airport was projected to fall short of the admissible expenditure. Hon’ble High Court of Kerala, in its judgement in the case of Commissioner of Central Excise Vs. Cochin International Airport Ltd. [2009 (16) S.T.R. 401 (Ker.)], has noted that the purpose of UDF “is to augment revenue”. Thus, UDF may be taken as a revenue enhancing measure to ensure economic viability of the airport operations.

5. It is noted that:

- (i) The project has an IRR and ERR of -0.71% and 0.24% respectively, which is way below the benchmark rate of 12% for the public projects.
- (ii) The project, including the project cost estimate, has been approved by the Central Government after due consideration.
- (iii) The NITB is expected to be commissioned shortly. Therefore, a decision regarding levy of UDF needs to be taken immediately.
- (iv) The Authority has not yet taken a final position in respect of economic regulation of airports. Therefore, the tariff determination in respect of the Trivandrum International Airport would take time. In the interim, the revenue enhancement through UDF could be considered, on an ad-hoc basis, as proposed by AAI. In case this is not considered, the target revenue and the loss to be recouped would be higher at the time of tariff determination.
- (v) The proposal made by the AAI does not contemplate any change in aeronautical tariff (i.e. airline related charges). The rates of UDF would have to be, therefore, calibrated based on the changes in the airline related charges that the Authority may allow at the commencement of first tariff cycle. Any increase in airline related charges is likely to result in reduction in rate/tenure of UDF.

6.1 In the light of the position noted in para 5 above, the submissions made by AAI along with the workings have been examined.

6.2 **Return** - AAI, has calculated the UDF rate such that the Net Present Value (NPV) of the profit after tax, from aeronautical revenues equals the NPV of the expected post tax return on the capital employed. The Target Revenue (TR) has been computed as: $TR = (EA + NA) * 12\%$

EA= Value of the existing assets at Trivandrum Airport

NA= Value of the New Asset

UDF = TR- Projected Revenue.

6.3 **Regulatory Asset Base (RAB)** - For the purpose of arriving at the RAB, the book value of the assets as on 31.03.2009 (Rs.78 crores) and value of the new assets (Rs.289.60 crores), i.e., the NITB to be commissioned in April'2010, has been considered.

6.4 Traffic Projections – Following traffic projections have been made in respect of passenger traffic and aircraft movements:

Passenger	Domestic	15% in 2009-10, 12% thereafter
	International	10% in 2009-10 to 2011-12 & 12% thereafter

Aircraft	9.7% in 2010-11
	8.9% in 2011-12
	10% in 2012-13 to 2016-17 and @ 10.9% upto 2019-2020

It is noted that the traffic projections are broadly in line with the past national trends viz. domestic traffic grew at a CAGR of 13% over the last 8 years; international traffic @ 13.9 % over the last 8 years and the aircraft movements @ 16.5 % over the 8 year period from 2001-02 to 2008-09.

6.5 Revenue :

6.5.1 Aeronautical Revenue - The growth of aeronautical revenues (landing, housing & parking) and Passenger Service Fee (PSF) is in line with the traffic projections for aircraft and passenger growth. However, no increase in rates of these charges has been contemplated. AAI has not considered any revenue from the Security Component of PSF and has correspondingly excluded the security expenses of the airport from the purview of UDF determination.

6.5.2 No revenues from Terminal Navigation & Landing Charges (TNLC) and Route Navigation Facility Charge (RNFC), for incoming flights, have been considered and the corresponding expenses have also been excluded.

6.6 Non-Aeronautical Revenue

6.6.1 Based on the increase in the terminal floor space due to the addition of the NITB (from 9000 sq mtr to 32000 sq mtr) AAI has projected its non-aero revenue from trading concessions, rent and services, to increase by nearly 100% (i.e. double) in the first year of commissioning, i.e., 2010-11. Thereafter, taking in to account the built-in escalation clauses in its commercial agreements as also agreements with Oil Companies for throughput charges, taking a long term view, 10% growth rate has been considered. Authority will go deeper into these projections at the time of final tariff determination and based on its final position in this regard as may be crystallized after taking into account the responses and submissions it has received on the Consultation Paper No. 03/2009-10 of 26.02.2010 referred to above.

6.6.2 AAI has not considered any revenue from City Side development at Trivandrum Airport. It has been stated that “AAI has decided to take up development of 10 airports in first phase i.e. Amritsar, Jaipur, Lucknow, Vizag, Bhubneswar, Indore, Ahmedabad, Begumpet, Kolkata & Guwahati. Since Trivandrum airport is not included in list, no revenue from it has been considered in the calculations.”

6.7 Expenditure :

6.7.1 **Pay and Allowances** – An increase of 25% in pay & allowances has been assumed in 2010-2011, 8% p.a from FY 2011-2012 to FY 2019-2020, excepting in FY 2017-2018 where the increase is assumed @ 30%. It has been stated that the effect of increments, increase in DA and promotions works out to approximately 8% and increase in staff expenses on commissioning of new terminal building by 25% takes care of the regular increase as also deployment of manpower commensurate with size and operation of the NITB. The 30% increase in FY 2017-2018 is estimated due to likely revision of pay scales w.e.f. 2017. It is reasonable to assume that the manpower requirement for managing the much bigger NITB would be on a higher side. The quantum of increase would require detailed examination at the tariff determination stage. However, the same is being accepted for the time being as AAI has projected an increase of 25% only when the area to be maintained would be three times bigger. Other assumptions also appear to be, prima-facie, reasonable in as much as :

- a) The 8% growth rate is stated to be based upon historical trends.
- b) The wage revision in Central Public Sector Undertakings is normally taken up after every 10 years and the last revision was effective 2007.

6.7.2 **Repairs and Maintenance (R&M)** - A 100% increase in R&M expenses in the year of commissioning (over the previous year's actuals) has been assumed and thereafter an increase at a rate of 10% pa. AAI has assumed a higher initial expenditure due to increase in terminal building area from 9000 sq mtr to 32000 sq mtr (old+new) involving larger area for upkeep, more civil & electrical repairs and inclusion of new equipments & systems under R&M. The projected increase, therefore, appears to be, prima-facie, reasonable, subject to detailed examination at the tariff determination stage.

6.7.3 **Electricity & Water Charges** - AAI has assumed an increase of 150% in the electricity and water charges (based on actuals of previous year) in the year of commissioning and thereafter an increase at a flat rate of 10% pa. The higher initial expenditure estimated by AAI is due to increase in terminal building area and consequently the increase in air-conditioning expenses, lighting and electrical & electronic equipments. The projected increase, therefore, appears to be, prima-facie, reasonable subject to detailed examination at the tariff determination stage.

6.7.4 **Interest on Borrowings** – AAI has assumed an interest rate of 9% on a loan of Rs.95 crores with 25% repayment from the financial year 2013-14 onwards. However, the same is only based on the action plan of AAI and the actual amount of loan and the interest rate may vary. In view of this uncertainty, the cost of debt cannot be determined. Hence, the same is not being provisioned for the present.

6.7.5 Other miscellaneous expenditure - AAI has not given any break-up of the miscellaneous expenditure. They have assumed an increase of 100% in the miscellaneous expenditure in the year of commissioning (over the previous year's actuals) and thereafter a regular increase @ 10% pa. Considering the large increase in the size of the terminal(s), these assumptions could be accepted for the time being subject to detailed examination at a later stage.

6.7.6 Apportionment of Corporate Head Quarters (CHQ)/Regional Head Quarters RHQ Expenses - AAI has assumed a uniform growth rate of 7.5% pa except in 2017-18 where a rate of 12% is considered. The expenses of CHQ & RHQ have been apportioned over the airports based on the number of employees which is, as per the existing accounting policy of AAI.

6.7.7 Depreciation – The depreciation rate applied is as per AAI's approved accounting policy considering the useful life of the assets. However, in the instant proposal, AAI has considered depreciation on straight line method at weighted average rate of 10% on the entire RAB (i.e. existing & new assets) and has claimed depreciation from 2009-10 on the new asset in their calculations. In the Consultation Paper No.03/2009-10, the Authority has stated that it will adopt a capitalised financing approach, which will ensure that users do not have to pay for assets until they have been commissioned and are in use. Hence, the UDF needs to be reworked to capture depreciation from FY 2010-11 onwards for the new asset, i.e., the NITB. Further, for a more accurate determination, the depreciation rates need to be considered as under :

- a) Actual rates, as per accounting policy, in respect of existing assets; and
- b) in respect of new assets in the absence of breakup of the individual components, the weighted average depreciation rate (11.75%) based on the classification of existing assets.

6.8 Weighted Average Cost of Capital (WACC) - AAI has assumed a post tax nominal WACC of 12%, which is the bench mark rate for public projects. Authority at this stage refrains from commenting on the this benchmark rate since this exercise is for ad-hoc determination of UDF. Tentative position of the Authority in regard to fair rate of return and determination of WACC is put forth in the Consultation Paper dated 26.02.2010 referred to above.

6.9 Till – AAI have assumed hybrid till with 30% non aeronautical revenue being considered for the UDF determination. However, the Authority in its Consultation Paper dated 26.02.2010, has tentatively decided to adopt "Single Till" approach. Thus, the "Single Till" approach could be adopted in the present case.

6.10 Corporate Tax – AAI has considered corporate tax rate @ 33.99%, i.e., standard rate.

6.11 **Discount rate** – AAI has adopted a discount @ 12% to determine the NPV of Target Revenue. Considering that the WACC is being taken @ 12%, the Authority, for the present, has taken the discount at the same rate as the WACC rate.

6.12 **Service Tax** – AAI has considered the levy of Service Tax on the UDF and has proposed the rates inclusive of Service Tax. Authority is conscious of the fact that in the case of Commissioner of Central Excise Vs. Cochin International Airport Ltd. (Supra), the Hon’ble High Court of Kerala has held that Service Tax is not leviable on UDF. However, this is an issue to be decided by the relevant tax authorities based upon the laws of the land. Therefore, UDF rates have been worked out exclusive of Service Tax. In case the same is held to be leviable, the incidence of such tax would be a pass through.

6.13 To Summarise:

- (i) AAI’s projections in respect of traffic (passenger & Aircraft movements), aeronautical revenue, expenditure (except interest on borrowings and depreciation) are proposed to be accepted for the present subject to detailed examination at the final determination of stage.
- (ii) The cost of borrowings is not being considered for the time being for reasons explained in para 6.7.4 above.
- (iii) New assets are proposed to be depreciated at weighted average rate of 11.75 from the year 2010-11 onwards.
- (iv) AAI has assumed a WACC of 12%, which is the same as benchmark rate for public projects. Discount rate is proposed at the same rate as the WACC.
- (v) Single Till is being adopted as against the 30% hybrid till proposed by AAI.
- (vi) Corporate tax is considered at the standard rate. Further, UDF rates are calculated net of Service Tax, if any.

7.1 Keeping in view the position explained above, the proposal has been reworked for a 10 year period and 15 year period. Calculations are also made if UDF is recovered only from international passengers. The details of four different scenarios are at **Annexures – IV, V, VI & VII**, which are summarized below :

UDF per embarking Passenger	Domestic	International
Net for 10 year period (Rs)	130	713 (say 710)
	0	759 (say 755)
Net for 15 year period (Rs)	130	529 (say 525)
	0	575

7.2.1 It is observed that in terms of Section 13 (2) of the Act, the tariff determination is to be made on a quinquennial basis. Therefore, it is for consideration whether UDF determination could be made for a 10 year or 15 year period.

7.2.2 UDF is considered a measure of revenue enhancement. From this perspective, Authority proposes to determine UDF over the five year term, recognizing the fact that in the second tariff cycle, UDF will need to be reworked based on the experience of the first regulatory cycle and future projections/forecasts for the subsequent ones.

8. In the above facts and circumstances, following options are available :

- (i) Whether to levy UDF @ Rs. 130/- per embarking domestic passenger and @ Rs. 710/- per embarking International passenger, on an ad-hoc basis, based on the figures for a period of 10 years; or
- (ii) Whether to levy UDF @ Rs. 130 /- per embarking domestic passenger and @ Rs.525/- per embarking International passenger on an ad-hoc basis, based on the figures for a period of 15 years; or
- (iii) Whether to levy UDF @ Rs. 755 /- per embarking International passenger on an ad-hoc basis, based on the figures for a period of 10 years; or
- (iv) Whether to levy UDF @ Rs. 575 /- per embarking International passenger on an ad-hoc basis, based on the figures for a period of 15 years.

9. On a careful consideration, it is felt that:

- (i) Balancing the interest of passengers (i.e. keeping the charges as low as possible) and the viability of the project, the UDF rates could be considered on the basis of figures for 10 year period.
- (ii) The determination is being made on an ad-hoc basis. NITB is meant only for international passengers. In the personal submissions made before the Authority, AAI has, on the balance, indicated a preference for restricting the levy to international passengers only based on the figures for a period of 10 years. Thus, for the present, levy is proposed only in respect of international passengers.

10. In view of the above, the Authority proposes to approve the levy of UDF at the Trivandrum International Airport @ Rs.755/- per embarking international passenger, (exclusive of statutory levies, if any) purely on an ad-hoc basis, with effect from the date of commissioning of the New International Terminal Building, based on the figures for a period of 10 years. This ad-hoc determination would be reviewed at the stage of tariff determination for the first cycle and thereafter at such intervals as the Authority may decide.

11. The Authority solicits feedback, comments and suggestions from stakeholders on the proposal contained in para 10 above. Comments/submissions may please be furnished to the Authority, **latest by Friday, 9th April, 2010**, at the following address:

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