

AIRPORT
INVESTMENT
ENCOURAGED BUT
UNCERTAINTY
REMAINS



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PERSPECTIVE

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India's long awaited Greenfield airport policy was finally announced on Apr-08. There were few surprises, nevertheless, it was a positive step forward towards achieving the Ministry of Civil Aviation's vision of 500 airports across the country by 2020. The policy recognises that future airport development will be largely led by the private sector.

Faster clearance and second airports permitted within 150kms

To fast-track the development process, greenfield passenger airports more than 150km from an existing airport will no longer require Cabinet approval. Instead, a steering committee will be established under the chairmanship of the Secretary of Civil Aviation to coordinate and monitor clearances. All non-passenger airports, regardless of their proximity to existing facilities, will be approved by the same steering committee.

Passenger airports within 150km radius of an existing airport will be permitted on a case-by-case basis, subject to Cabinet approval. This revision was necessary due to the fact that a combination of economic and political drivers were placing pressure on this arbitrary exclusion policy.

In the case of Mumbai, the limited room for expansion at the current airport means that a second airport is imperative. The airport is likely to reach saturation by 2012. In fact the city is facing a potentially serious threat to its economic competitiveness if plans for a second airport do not progress urgently. The site which the Ministry of Civil Aviation has selected in Navi Mumbai has not received the required clearances from the Ministry of the Environment. Further delays, or the need to find an alternative site, will make it very challenging to construct and open the second airport by 2012.

Meanwhile, in the case of Delhi Airport, capacity constraints are not an issue, with the airport having a significant land bank for expansion. The demands for an airport at Greater Noida, just over 70km from the Indira

Gandhi International Airport, are driven instead by political issues.

The revised policy is likely to see the Greater Noida project move ahead, however it may impact Delhi's development as a hub. Nevertheless, Delhi Airport may be the beneficiary of increasing congestion in Mumbai as it accepts spillover traffic. Delhi is therefore likely to overtake Mumbai as India's largest airport in terms of passenger traffic within the next 1-2 years.

Opening up the sector to permit airports within 150km of existing facilities was inevitable in order to achieve the level of connectivity envisaged. However, the fact that approval will be on a case-by-case basis, with no clear guidelines on the assessment criteria used, means that the level of transparency will remain short of that which investors would like.

Connectivity to be encouraged to Tier 3 cities

Meanwhile, the Cabinet also officially approved the Ministry of Civil Aviation's proposal to allow the construction of airstrips and helipads for private use. All proposals for private constructions will now be decided by the Ministry of Civil Aviation and Directorate General of Civil Aviation (DGCA).

The policy will improve connectivity to smaller centres and reduce the burden on commercial airports. This will represent the third phase of development of air traffic in the country, designed to encourage connectivity beyond the major metros to encompass smaller cities and remote areas.

- **Stage 1:** The rapid expansion of air traffic in the last five years has been concentrated on the six metro airports of Delhi, Mumbai, Kolkata, Chennai, Bangalore and Hyderabad. The focus on larger airports using narrowbody jets has resulted in the overcapacity on these routes which we see today;
- **Stage 2:** The government subsequently took the step of encouraging services to Tier 2 cities with the announcement of a regional airline policy in Sep-07, providing concessions to operators of aircraft with fewer than 80 seats, and an airport upgrade program for 35 non-metros cities. The process of inviting private sector participation in the commercial development of non-metro airports progressed last month, with the announcement on 16-Apr-08 of shortlisted bidders for landside operations at Amritsar and Udaipur airports;

- **Stage 3:** The new policy permitting the development of smaller general aviation facilities, and the decision in Jan-08 to increase the foreign direct investment cap in general aviation from 49% to 74%, should provide a fillip to the sector and encourage connectivity to Tier 3 cities.

Regulator for aviation sector to be appointed by Oct-08

Although private investment is being encouraged in greenfield airports, one of the critical issues which investors seek clarity on is the regulatory framework within which they will operate.

The Ministry of Civil Aviation confirmed plans to appoint an independent regulator, the Airport Economic Regulatory Authority, for the aviation sector by Oct-08. The regulator would be responsible for setting guidelines on and monitoring aeronautical charges, user development fees, passenger charges etc.

The motion is scheduled to be further discussed during the 'second half of the Budget session', with recommendations from a steering committee to be taken into consideration.

Investors watch opening of Bangalore Airport with interest

Although the new greenfield airport policy is intended to encourage private sector participation in the airport sector, investors will be observing recent developments at the new Bengaluru (Bangalore) International Airport with some concern. The opening of the new facility, which was postponed until 11-May-08, has been delayed again, resulting in further lost revenue for the operator.

The airport was originally scheduled to open in late Mar-08, but that was deferred following a request from the Indian Ministry of Civil Aviation for an opening "after 10-May-08", due to reported delays by the Airports Authority of India (a 13% owner of BIAL) in training Air Traffic Control (ATC) services staff at the new facility.

BIAL dutifully informed the aviation community that the airport would open on 11-May-08. Media reports at the time suggested BIAL would lose USD10 million in revenue. BIAL CEO, Albert Brunner, stated in early Apr-08, "the concessionaires have reacted very reasonably [to the delay]. But they will not, if it is postponed again".

The Ministry of Civil Aviation has now stated that the opening of the new airport would not occur until the "last week of May". No reason was given for the latest delay.

However, with state assembly elections scheduled to be held from 10/11 May, the government may prefer to avoid performing the politically contentious act of closing the current airport during the polling period.

It is a cause of considerable frustration for BIAL, a consortium formed to build, own and operate the new airport. Private promoters hold a 74% stake in BIAL, led by Siemens Ventures with a 40% share, Swiss airport operator, Flughafen Zürich AG with a 17% stake and Larsen & Toubro with 17%, while the State holds the remaining 26%.

Ministry of Civil Aviation considers keeping HAL Airport open

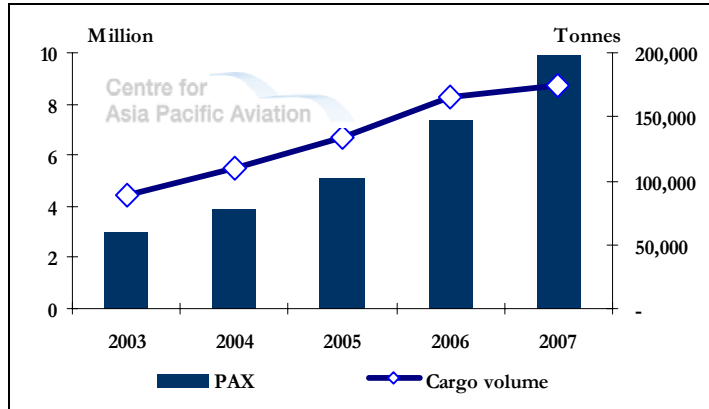
Ministry of Civil Aviation meanwhile is considering the possibility of allowing the existing Bangalore HAL Airport to remain open for small non-scheduled aircraft, following the launch of the city's new airport, despite an agreement with BIAL prohibiting such a move. The Ministry is now planning to meet with BIAL on 12-May-08 to try to thrash out a deal.

It is not the first time problems have surfaced with the Bangalore Airport project. As air travel demand in India surged, BIAL realised the original design of the new airport would be too small and conducted a re-design of the project at the same time as construction work was in progress. BIAL has also been in dispute with airlines and the government over the airport's proposed user development charges (UDF).

The existing airport in Bangalore, recorded a 35% increase in passenger traffic in 2007, although growth rates could be lower in 2008 as the market shows signs of cooling down and capacity limits have been reached.

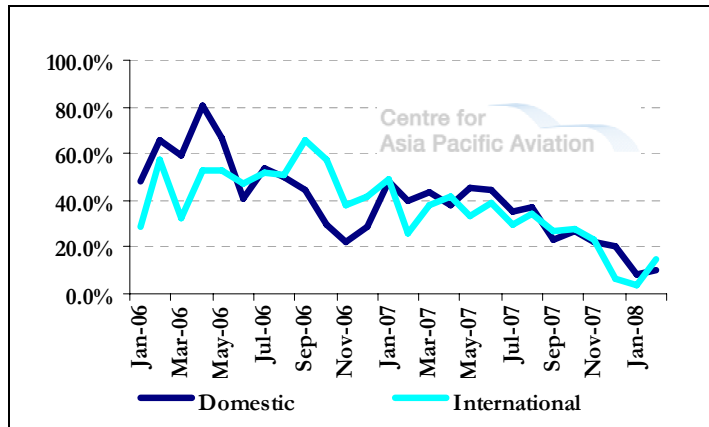
Bangalore airport annual passenger numbers and cargo volume:

2003 to 2007



Source: Centre for Asia Pacific Aviation & ACI

Bangalore airport monthly domestic passenger numbers growth and international passenger numbers growth: Jan-06 to Jan-08



Source: Centre for Asia Pacific Aviation & AAI

The events at Bengaluru may also indicate a clash of cultures. BIAL's senior management are highly accomplished professionals, bringing with them the highest standards of Swiss precision in airport operations. But they may be less well-equipped to navigate India's multi-layered bureaucracy and political environment. Perhaps BIAL (and future investors in India's airport sector) could benefit from some local talent in its senior executive ranks.

Conclusion

The last month has revealed a mixed bag for airport development in India. Although the government continues to make real progress in pursuing policy initiatives designed to encourage private sector participation in airport construction, uncertainty remains with respect to the approval process and the regulatory framework. Approval of several critical elements remains on a case-by-case basis, a feature that has characterised Indian aviation policy in recent times.

Meanwhile, resolution of the Bangalore Airport concession issues will be watched with interest by prospective investors. The situation in Bangalore may stem partly from the fact that the concession agreement was entered into at a time when aviation was a relatively dormant sector in India, and many of the issues encountered today were not even envisaged. Prospective investors will be hoping that lessons will be learned from this process and applied to future projects.