

An aerial photograph of an airport terminal and tarmac. The terminal is a large, modern building with a curved roof. The tarmac is filled with several aircraft, including a large white jet and a smaller blue and white plane. The surrounding area is a mix of green fields and paved roads.

RISK & DUE DILIGENCE IN AIRPORT PRIVATIZATION

Victor F. J. Craig
Director Air Transport
Halcrow AirPlan - Malaysia

Risk & Due Diligence in Airport Privatization

Presentation Contents

- Concept and Forms of Privatization
- Who is at Risk in Airport Privatization ?
- Risk Elements
- Due Diligence Approach
- Components of Due Diligence Assessment

Role of the Consultant in Airport Privatization

- **Assisting Bidders**
(Financial & Technical Role)
- **Assisting Governments**
(Project Preparation, Risk & Bid Evaluation)
- **Assisting Investors (Risk Assessment)**
Increasing Role in Risk Assessment & Due Diligence

Risk & Due Diligence

Risk is

“chance or probability of an unexpected event occurring, or an expected outcome not being realized”

Due Diligence.....

“to take careful and proper account of all factors pertaining to a proposal, in order to validate claims and establish credibility”

Background to Risk Issue

- Privatization in airports commenced in mid-1980's - only limited experience
- Success of privatization in airports ?
Evidence of under-performance in projects
- Conclusion that risk has been underestimated - in forecasting revenues and capital costing

Need to identify & manage risk in project preparation and bidding

Airport Privatization Concept

Wide Range of Concepts

- Concession for single airport
- Concession for multiple airports system
- Sale of shares in single or multiple airports to the public
- Concession for airport facility development under Build-Operate-Transfer (BOT)

Above concepts may also necessitate restructuring civil aviation administration

Public Sector - Private Sector Interests

Government Interest to..

- Ensure airport and facility upgrading and expansion
- Obtain relief from future need for public capital investment
- Obtain relief from responsibility for supporting cost of operations & maintenance

Potential for “windfall” profit from sale of assets or concession also attractive

Public Sector - Private Sector Interests

Private Sector Interest..

- Limit capital expenditure to minimum that can be recovered within concession
- Ensure there is a sufficient revenue base to offset operating costs, capital charges, royalties, and generate profit and return on equity

Public Sector and Private Sector objectives may not always be in harmony - hence risk to parties involved

Who is at Risk in Airport Privatization ?

- Bidders and Concessionaires
 - Commercial Banks & Regional Development Banks
 - Governments
-but also the Airlines and User Public

Risk Elements in Privatization

- Air Traffic Forecasts
- Airport Development Proposals
- Air Transport Risks
- Revenue Estimates
- Capital Cost Estimates
- Concessionaire Composition & Culture
- Institutional Influences
- Terms of Reference for Privatization

Risk Elements in Privatization

Air Traffic Forecasts

- Annual Traffic Forecasts - passengers, cargo & aircraft - for revenue estimation
- Derived Peak Forecasts - used to generate capacity needs and capital estimates

Sensitivity testing may be lacking

Linkage between annual & peak forecasts may be inconsistent

Forecasts based on new markets being developed may mask considerable risk

Risk Elements in Privatization

Airport Development Proposals

- Aircraft Safety
- Airside & Terminal Design
- Capacity & Site Expandability







Risk Elements in Privatization

Air Transport Risks

- Changes in Aircraft Mix
- Problem of Competing Airports
- Airline Alliances

Risk Elements in Privatization

Revenue Estimates

- **Reliance on Traffic Forecasts**
Can be overly optimistic
- **Fees & Charges Assumptions**
Ability to increase charges may be unrealistic

Risk Elements in Privatization

Capital Cost Estimates

- Lack of adequate prior planning
- Insufficient information on site conditions and local costing

Leads to under-estimated capital needs

Risk Elements in Privatization

Concessionaire Composition & Culture

- Range of Disciplines in Consortium
Watch for “dominant partner” effect
- “Developer” Syndrome
Low cost - short life approach

Risk Elements in Privatization

Institutional Influences

- Government regulation of air transport may affect concessionaire revenues
- Policy towards privatization can change
 - issue of compensation
- Commitment to mitigate environmental impact of airport operations may weaken

Risk Elements in Privatization

Effect of Terms of Reference

- Tendency to focus on financial return to government.
- Technical requirements usually ill-defined

Government loses control over physical scope of the project

Poor terms of reference make it difficult to evaluate bids

Components of Due Diligence

- Air Traffic Forecast Review
- Airport Facilities Development Plan
- Operations Review
- Regulatory Influences
- Financial Review
- Other Development Risks & Opportunities

Conclusions

1. Risk exists for all parties
2. Experience too limited to declare success
3. Not all airports or projects financially viable
4. Risk elements need to be addressed
5. TOR need to be much better defined
6. Due diligence reviews needed at all stages

Final Thought

***If you plan to privatize an airport, or
initiate a BOT project...***

....do the due diligence work first