
The prospects for airport PPPs in Indonesia



By **Julian Smith**, Director,
PT PricewaterhouseCoopers Indonesia Advisory

This article sets out the current status of airport investment in Indonesia, explains the obstacles to greater private sector investment, and suggests some actions the Government could take in order to speed up investment in Indonesia's airport capacity.





Introduction

Civil aviation has been growing fast in Indonesia in line with the economy. From 2012-2016, the number of domestic flights grew on average by 5.2% per annum and the number of international flights by 4.4%. The number of aircraft operated by the five biggest Indonesian airlines grew from 331 in 2013 to 539 in 2017. Consequently, almost all of Indonesia's major airports are operating in excess of their design capacity. This article summarizes the current status and plans for Indonesia's airports and identifies the actions the Government needs to take to secure significant foreign investment to upgrade the facilities in line with the needs of the economy.



Current plans

The Government has plans to boost investment in tourism by creating "Ten new Balis", which will generate further demand in addition to the needs of the underlying economy and the growing disposable income of a growing and more affluent middle class. The Government has built new airports in Silangit (North Sumatera), Letung (Anambas), Tojo Una-Una (Central Sulawesi) and Maratua (Derawan) in the last five years and also plans to build five more new airports across the country (which will increase demand on the existing hubs at Jakarta, Surabaya and Denpasar). There are plans in place to expand most of the major airports operated by Angkasa Pura (AP) I and II but funds have not been identified to enable all of these plans to be implemented. The National Mid-Term Development Plan 2015-2019 also targets massive investment in other sectors and assumes that 36.5% of the total will be financed by the private sector. Since airports are much more suitable for private finance than many other areas such as sanitation or education, and many of the projects are revenue generating and financially viable, it is essential that they be financed by private sector essential that they be financed by private sector investors where possible. The application of the profit motive can at the same time bring about a significant improvement in the quality of passenger service and the level of safety.



Current industry structure

Almost all airports in Indonesia are owned by the Government. 26 of the 27 busiest are operated by state-owned enterprises ("SOEs"), AP I and II, under concessions from the Ministry of Transport (MOT). Batam Airport, a major domestic regional hub, is an exception, being operated by the Batam International Free Zone Authority (BIFZA), which is a unit of the Ministry of Finance. The 211 other public airports in Indonesia are mainly operated by units of the Ministry of Transport, though the MOT recently announced that management of some of these would be transferred to AP I and II to release funds for its construction programme.



Options for financing new airports

So far all new airports and expansions, including Terminal 3 at Soekarno-Hatta, have been funded directly by public money, mainly through MoT, API or APII. The construction of Kertajati airport in West Java has been funded by the Provincial Government (but so far has only one scheduled daily flight). The main exceptions have been in Denpasar, Bali, where the landside facilities are operated under a management arrangement with GVK of India, and Bintan, where a private group, Salim Group, is financing and building a new tourist airport which will be operated by AP II.

The current Minister of Transport has expressed a desire to attract international private investment to reduce the burden on the state budget, but so far this has not occurred. The National Mid-Term Development Plan 2015-2019 identifies ten new airports to be developed through Public-Private Partnerships ("PPPs") and the MOT recently increased that to 15, though the details have not been announced. AP I and II have said they will involve the private sector in management of some of their airports under a "Joint Operation" or "B2B" scheme and announcements from AP I and II are not always aligned with those from the MOT. The MOT carried out a market sounding in 2015 and concluded that the private sector was not interested in the PPPs but it now seems correctly to have reconsidered this conclusion.

Currently the Final Business Case for a PPP for the expansion of Komodo Airport is being developed by Indonesia Infrastructure Guarantee Fund ("IIGF"). The Government expects to tender the project in 2018.

At the same time, BIFZA has completed a Pre-feasibility Study for a PPP for the expansion of Batam Airport as part of its plans to develop the free zone as an international and domestic logistics hub and this project is expected to come to the market soon.

PT Gudang Garam Tbk has expressed interest to build a new airport in Kediri, Central Java under a PPP scheme. MoT is currently reviewing the proposal and KPPIP has proposed to include Kediri Airport in the list of National Strategic Projects. In parallel, the Government's Committee for Acceleration of Priority Infrastructure Delivery (KPPIP) has developed a new approach, called "Limited Concession Scheme" (LCS) as a method for procuring new private investment in the expansion of existing airports and also releasing cash for recycling into other projects. It is planned to apply this scheme to the airports at Medan and Lombok currently operated by AP I and AP II respectively, but the requisite Presidential Decree has not yet been issued.

However, given the great need for new airport capacity, progress seems slow and piecemeal with many announcements but no actual tenders being launched. In contrast, the Philippines, with a similar economic profile and market need signed a PPP for the development of Mactan-Cebu International Airport in 2015, with four more PPP projects in the pipeline.

Obstacles to airport investments in Indonesia

There are many reasons why Indonesia has been slow to bring private funding into the airport sector:

1 The current concession structure

The current structure was designed to enable the corporatisation of airport operations by transferring them from the MOT to API and APII. It does not facilitate the next step towards private operation, e.g. it is not possible to grant a sub-concession. The passenger tariff, which is the main source of revenue, must be paid to the concessionaire, not to a private operator. Regulatory change is a slow process in Indonesia, even if the need for change is universally agreed, which is not yet the case here. The structure is also complicated, with a variety of licences being required in addition to the main concession.

2 Airport licensing

Similarly, there is no precedent yet for private sector operators to be awarded an airport operating licence ("BUBU") and therefore most investors might need to work with AP I or AP II which already hold these licences. In other countries that have done airport PPPs, there is no such requirement to form a partnership with a SOE, especially if that SOE does not have funds to invest in the equity.

3 The "Negative Investment List"

This regulation limits foreign investment in many sectors. For airport and airline operations, the maximum foreign ownership is 49%. Many sectors, such as toll roads and power plants, have been liberalised in recent years, but liberalisation would be difficult in aviation because there is also a separate similar requirement enshrined in primary legislation (the Aviation Law - No1/2009) which is unlikely to be changed.

4 Tariff increases

Airport concessions in other countries often provide for an automatic annual increase in tariffs to enable operators to cover inflationary increases in operating costs. In Indonesia, the existing regulatory regime does not give such certainty as tariff increases must be approved by the Government. Toll road concessions offer a useful precedent as the concessionaires are entitled to an inflationary increase every two years as long as they are in compliance with their performance obligations under the concession. Without such a commitment, private investors are likely to regard Indonesian airport investments as too high risk, because it will be some years before the revenue from retail and other non-aeronautical sources can compensate for any shortfall in the revenue from passenger and aircraft tariffs.

5 Development of new air routes

Despite congestion in the major hub airports of Jakarta and Denpasar, most regional/local airports in Indonesia are still not open for direct flights to/from other ASEAN countries, even though ASEAN governments have agreed in principle to implement the ASEAN Single Aviation Market (ASEAN-SAM), which in theory allows such flights without needing permission from the Government. Indonesia has not yet ratified this in respect of secondary airports. For example, if you want to fly between Eastern Indonesia and most cities in the Philippines, you generally have to transfer in a major hub such as Kuala Lumpur or Singapore, many kilometres to the West. Local economies including tourism investment could be stimulated and the congestion in the hubs relieved if these restrictions were relaxed. The potential for shorter flights is indicated by the small number of routes operated by MAS Wings between Indonesian and Malaysian parts of Borneo as part of ASEAN regional integration initiatives. The sector would benefit from liberalisation of the process for approving new routes more generally.

6 Regulation of new airlines

Aviation Law 1/2009 requires all new airlines to have a minimum of ten aircraft in order to obtain an operating licence. This is a major obstacle for entrepreneurs in more remote provinces who might be interested to start up an airline to serve their local market. Proper safety regulation is essential, but the number of aircraft is not a direct determinant of safety. In practice the law (combined with the slow implementation of Open Skies) has the effect of reducing the number of flights which serve remote airports, thus undermining their profitability and attractiveness to investors. Whilst major airlines such as state-owned Garuda and private sector Lion Air do a great job of launching pioneer services, sometimes with government subsidy, they are bound to prioritise more lucrative established routes.

As an example, in India where aviation is more liberalised, Zoom Air, an Indian airline which operates only five aircraft focusing on under-served destinations has been able to provide good services to its passengers with a low number of complaints, delays, and flight cancellations and a good safety record.



What needs to be done to facilitate private investment in Indonesia's airports?

There is no shortage of international interest in investing in Indonesia's airports and since there are no experienced local private sector airport operators, most investment must come from overseas. The record in other sectors such as power and toll roads shows that Indonesia's infrastructure is attractive to foreign investors. Indonesia's economy is forecast to be among the Top 5 globally by 2030, and unlike other infrastructure sectors, which depend on government payments, airports give access to Indonesia's burgeoning consumer market. So all that is needed is to simplify and reduce the burden of regulation so that the deals can be done. A typical international standard PPP or concession agreement gives ample protection to the national interest – for example there is no obstacle to military use of the airport in time of crisis, and the PPP can be terminated if the private operator does not perform well (though normally the investors and banks will step in to fix the problem before the Government needs to).

The existing PPP legislation, and the new LCS both offer workable models. The main step that is required is to adjust the existing concession law, or even disapply it from an airport where investment is targeted, since it mainly duplicates the PPP/LCS provisions, and then tenders could be launched and agreements signed within twelve months. It is however an essential pre-requisite to carry out a thorough feasibility study to define the investment needs for each airport, and then allow some flexibility in the concession/PPP for the private investor to optimise the investments to suit the market. It is also essential to implement a reasonable and fair mechanism for annual tariff increases. Changes to the other regulations such as Open Skies and the Negative Investment List may take longer.

In conclusion, if the Indonesian government is serious about attracting private investment in airports, it may need to set up a task force to simplify the regulatory issues and bring some deals to the market.

Contacts

To have a deeper conversation about how this subject may affect your business, please contact:



Julian Smith, Director
+62 21 521 2901 ext. 81966
smith.julian@id.pwc.com

PwC Indonesia is comprised of KAP Tanudiredja, Wibisana, Rintis & Rekan, PT PricewaterhouseCoopers Indonesia Advisory, PT Prima Wahana Caraka, PT PricewaterhouseCoopers Consulting Indonesia, and Melli Darsa & Co., Advocates & Legal Consultants, each of which is a separate legal entity and all of which together constitute the Indonesian member firm of the PwC global network, which is collectively referred to as PwC Indonesia.

© 2018 PwC. All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see <http://www.pwc.com/structure> for further details.