



3 September 2018

Airport Regulation Inquiry
Productivity Commission
Locked Bag 2
Collins Street East VIC 8003

Dear Commissioner,

Productivity Commission Inquiry into Economic Regulation of Airports

IFM Investors has made a joint submission into the aforementioned inquiry with other Australian airports investors, but welcomes this opportunity to provide an individual institutional perspective. IFM Investors holds more direct equity in unlisted Australian airports than any other institution.

IFM Investors is an investor-owned global fund manager with A\$107 billion under management¹ across infrastructure, listed equities, private equity and debt investments. IFM Investors is owned by 27 Australian profit-for-members, industry superannuation funds, and invests on behalf of the retirement interests of more than six million Australians. IFM Investors is headquartered in Melbourne and has offices in Sydney, London, New York, Tokyo, Seoul, Hong Kong and Berlin. The firm employs more than 300 staff worldwide, of which 70 are infrastructure specialists.

IFM Investors is one of the world's largest managers of infrastructure managing over A\$47 billion in infrastructure equity across the globe, in every sub-sector within the infrastructure asset class. IFM Investors manages two open-ended pooled infrastructure funds, IFM Australian Infrastructure Fund ("IFMAI") and IFM Global Infrastructure Fund ("IFMGIF").

In Australia, IFM Investors, through IFMAI, has investments in nine airports valued at over \$4.3 billion². These are the capital city airports of Melbourne, Brisbane, Perth, Adelaide and Darwin, as well as the regional airports of Alice Springs and Tennant Creek (NT), Launceston (TAS) and Parafield (SA).

Globally, IFM Investors, through IFMGIF, has an ownership interest in Manchester and Stansted Airports in the UK, Vienna International Airport in Austria (which owns Malta Airport), and Toluca Airport in the State of Mexico.

Through our portfolio of assets, we are exposed to a wide range of economic and regulatory constructs. Each of these constructs has different risk characteristics and different incentive mechanisms.

Airports that are subject to light-handed regulation have greater risks than other subsectors within the infrastructure asset class, and have substantially more risk than regulated airports. These risks include:

- Significant capital expenditure requirements for long lead time aeronautical infrastructure and capacity investments. The risk of time and cost overruns, which can be significant given that construction is usually taking place in a live, operating environment, resides completely with the airport owners;

¹ As at 30 June 2018

² As at 30 June 2018

- ‘Step change’ capital expenditure requirements (such as new runways or new terminals) which can double capacity but serve limited passengers for many years until volumes catch-up with the capacity addition;
- Capital expenditure risk for non-aeronautical expenditure which may or may not be recovered through other revenue sources;
- The realisation of passenger forecasts over the term of an airline pricing agreement. This risk is exacerbated by an incentive for airlines to “game” forecasts to reduce the forecast per passenger costs;
- Changing regulation that can have a substantial negative impact on retail revenue, including the loss of “Duty Free” within the EU, and tobacco restrictions globally;
- Reduced passenger retail spend at airports due to the growth in on-line shopping often through the use of mobile devices;
- Regional economic risks, relating to reduced passenger numbers (and passenger spend) during recessionary periods or periods following major regional economic events (for example, the mining boom in WA and LNG in the NT);
- Airline failures (Monarch Airlines in the UK which failed last year, Ansett, Compass, Air Australia) which can leave an airport with significant bad debts and reduced passenger numbers;
- Airline route decisions which are often made with limited or no notice and which can have a substantial impact on passenger numbers particularly for smaller city and regional airports;
- Geopolitical risk, including the real risk that a foreign government limits outbound tourists to a market because of a broader geopolitical issue. This risk is increased if an airport has built capacity to cater for a growth market and that market is disrupted for an extended period; and
- Shock event risks, such as SARs, Bird Flu, and 9/11, which have had major short-term impacts on passenger numbers.

Regulated airports, in contrast, are not subject to these risks. Rather, the risk manifests through higher regulated passenger charges on those passengers who continue to travel.

Equally, however, airports subject to light-handed regulation have greater incentives for outperformance. This includes:

- Dedicated and incentivised route development executives seeking to create new “city pairs” to bring inbound tourists. For example, each of Melbourne, Brisbane and Darwin Airports have had multiple visits into China as they have added additional routes. Often, the route development trips are done jointly with the City or State tourism boards. The collateral benefits for the cities and regions where the airports are located is well understood by tourism officials;
- Substantial research and development of digital interaction with passengers to enhance the passenger experience (through more immediate information) while increasing the passenger spend rate;
- A constant focus on minimising wait times for immigration and security (without compromising safety), in order to optimise the amount of dwell time available for airport shopping;
- Highly competitive tendering requirements for capital projects to minimise the cost of expansion, coupled with an intense focus on capital delivery and mitigating time and cost overruns;

- A genuine focus on cost control through initiatives such as energy efficiency and on-site generation. Within our airports portfolio we have invested in complete LED lighting conversion, tri-generation energy facilities and meeting up to 100% of energy needs through solar generation;
- Innovative solutions to increase airport capacity while deferring major capital expenditure. Examples include bifurcating full service from low-cost carriers and the sharing of domestic and international infrastructure (e.g. 'swing' gates);
- Regular and competitive tendering for service providers, including security and cleaning, to keep costs as low as possible while maintaining appropriate standards; and
- Collaboration with airlines to avoid unnecessary expenditure and provide capacity as close as possible to the needs of the market.

Regulated airports, in contrast, do not benefit from these incentives, and have little financial motivation to pursue such measures.

Financial risks and opportunities mean that airport owners and management are intensely focused on risk reduction, asset optimisation, cost control and new business creation. All of these measures support airport productivity.

Commercially negotiated outcomes that are fostered under the light-handed regulatory regime result in outcomes that benefit airlines and passengers. Accordingly, we have supported over \$7.2 billion of capital expenditure at our nine Australian airport investments over the last decade.

Our investment in Australian airport capital expenditure is almost double what we have received in dividends from these assets. Going forward, we expect to support a further \$8.7 billion in capital expenditure across our Australian airports in just the next five years.

Light-handed regulation has provided the stable and consistent regulatory framework which has allowed investors to fund the tremendous volume of capital investment required to cater for growth in Australian air travel. Equally, it has created a balanced risk and reward construct that encourages cost control, innovation and growth.

Any fundamental changes to the current framework would reduce investment certainty, confidence and productivity.

If we can provide any further assistance or clarify any part of this submission, please do not hesitate to contact Marigold Look, Investment Director,

Yours faithfully

Kyle Mangini
Global Head of Infrastructure
IFM Investors Pty Ltd