Cyprus' Airports PPP *"Best Transport Project in Europe"*

Alecos Michaelides examines the PPP, a template for the continuing development of the country's infrastructure

The project, which was signed on the 12 May 2006, is a 25-year Build-Operate-Transfer (BOT) concession for the operation and development of Cyprus' two international airports at Larnaka and Pafos. Under the terms of the agreement, the concessionaire (Hermes Airports Limited) took over the existing airports and constructed new passenger terminals and associated infrastructure at both airports, investment worth around €600 million.

Together, the new terminals are able to handle over 10 million passengers annually to a high level of quality standard. The company undertook further expansion of the airports as demand required. The Concessionaire took over the airports and received all revenue generated at the airports. However, in return for the exclusive right granted by the Cyprus Government the Concessionaire will be paying an annual concession fee comprising of a fixed guaranteed amount of €3.5 million plus an amount equal to 33% of the Gross Revenue. Additionally, the Cyprus Government participates in a profit sharing arrangement.

The award of the concession was the result of a highly competitive tendering process which attracted some of the world's leading airport operators and construction companies. Bidders were provided with a draft concession agreement which encapsulated the risk transfer in the project, and were assessed on the degree of acceptance of such risks.

Essentially, the following risks have been transferred to the private sector: revenue (including traffic), operating, design & construction, and financing. This was followed by long and intensive negotiations between the Cyprus Government, the Concessionaire and their lenders to address a number of key and unique risks.

A risk which was successfully addressed was the potential impact of any external events causing sudden drop in traffic eg. 9/11. The Government had built a number of mechanisms in the Concession Agreement in order to safeguard public interest given the strategic importance of the airports. Such mechanisms include a performance regime, a regulatory framework for airport charges and a profit sharing mechanism.

The Concessionaire is subject to a performance mechanism that both penalises underperformance and rewards exceptional performance, thus incentivising innovative service delivery. There is significant innovation in the risk allocation process which takes into account local factors and global industry factors (events that are outside the control of the two Parties and cause sudden drops in traffic eg. 9/11).

Another innovation has been in the transfer of public employees to the private sector where working together with the Concessionaire there has been safeguarding of employee rights beyond the usual norms. Also, any financial adjustments or compensation between the Parties, will be done in such a way so that both Parties will be in a *"no better no worse position".*

It should be clarified at this point that there were two categories of existing employees to be considered with respect to the concession for the Airports: Public (or Civil) Servants, and Permanent Hourly-Paid Workers.

Both categories were employed by the Government, and the latter, through the Department of Civil Aviation.

All Public Servants employed at or in relation to the Airports (at the time 66 employees) continued to be employed by the Government but not in a role that conflicted with the responsibilities of the Concessionaire.

The deal also represents one of the most contemporary airport sector concession deals, and particularly in the post-9/11 aviation sector, sets the standard for sustainable risk transfer

The permanent hourly-paid workers at the Airports at the date of the signature of the concession were all eligible for transfer to the Concessionaire (the workers are hereafter referred to as 'Eligible Employees').

Eligible Employees continued to be employed by the Government (estimated at the time to be about seven hundred (700) employees) during the Transition Periods. These Periods were estimated to be up to two (2) years until the opening of the new terminal at Pafos and three (3) years until the opening of the new terminal at Larnaka. During these Periods, all Eligible Employees were, however, subject to the day-to-day management control of the Concessionaire, under a management agreement with the Government. The Concessionaire made payments to the Government to cover the latter's payroll obligations for these Employees.

Prior to the end of the Transition Period, the Concessionaire was obliged to make an offer of employment to all Eligible Employees. These offers ('Eligible Offers') were made in good faith and on terms and conditions equivalent to, or better than, those that such Eligible Employees had immediately before the Eligible Offer was made.

If the Eligible Employee rejected the offer made by the Concessionaire, he/she continued to be employed by the Government but not at the Airports.

The Concessionaire was required to make a compensation payment to the Government of two (2) years' annual gross salary for each Eligible Employee who was still employed at the end of the Transition Period but had rejected an Eligible Offer, which had been made in good faith by the Concessionaire.

In the event that large numbers of Eligible Employees chose not to transfer to the Concessionaire due to reasons beyond the control of the Concessionaire, the Government shared that risk by limiting the total level of such compensation payable to it by the Concessionaire to seventeen millions and one hundred thousand euros (€17,100.000).

From the launch of the tender process (expression of interest) the Cyprus Government emphasised the need for airport operators to play a leading role in the Consortium. In the case of Hermes Airports, there are three airport operators (YVRAS, Aer Rianta and Nice Airport) bringing innovation to the operation of the airports. Equally, consortia were encouraged to involve Cypriot companies in the project as a key objective of a PPP is to transfer skills and know-how to local markets. In the case of Hermes Airports Ltd, four of the nine participating member companies are Cypriot.

The Concessionaire has made agreed modifications to existing designs for the new passenger terminals at both Airports, thus retaining the design risk. The design quality was to be measured against specific industry standards, being IATA Level B for Larnaka International Airport and IATA Level C for Pafos International Airport and against detailed specifications contained in the Concession Agreement. The design takes into consideration local characteristics and architectural features as well as a unique sense of place that will make a lasting impression on passengers. Also modular design allows for easy expansion that will sustain the original design concept. Some details regarding planning and standards/regulations are given below:

Planning

A detailed analysis of the key passenger processing functions based on predicted passenger growth was undertaken and it is this that forms the basis for all area requirements and informs the general planning and organisation of the Terminals.

Pafos – designed for 2.7 million passengers per annum is designed on a single level with Arriving and Departing passengers segregated horizontally within the space.

Larnaka – designed for 7.5 million passengers per annum has therefore been planned on five levels with the main passenger functions of Arriving and Departing being vertically segregated to enhance security.

Standards/Regulations

The new Terminals have been designed to International standards for planning and processing in order to optimise space and facility requirements.

Detailed planning will incorporate local Cypriot legislation where appropriate supported by European Norms and/or British Standards. The planning and organisation has been informed by the requirements of the brief and in discussions with the Airport operators, Government Users, Airlines and Commercial stakeholders.

The detailed design of both Terminals has been developed in conjunction with the Cyprus Fire brigade to ensure that all life safety systems have been incorporated in accordance with their requirements.

Both Terminals have been designed to provide safe and easy access for all mobility impaired passengers.

In addition, a number of environmentally friendly and energy efficient systems are being incorporated in the design of the new facilities, especially for the air conditioning and the lighting control.

With respect to risk transfer, despite a revenue risk being transferred that is relatively volatile compared to other PPP sectors, particularly in the post 9/11 environment, the €600 million project is being financed with an aggressive financing structure (90% gearing). This has all been achieved through an all-party (Government, Concessionaire, Lenders) effort, not least with respective home locations scattered across the globe (eg. Cyprus, UK, France, Canada, Bahrain). Further validation of these efforts is evidenced by the successful syndication of the Bank senior debt in September 2006, where strong appetite for the deal resulted in the participation of another 12 leading European banks [in addition to the four co-lead arrangers].

This deal is the first major PPP entered into by the Cyprus Government, leading the way for future PPPs in the continuing development of the country's infrastructure. In particular, with Cyprus being an island and international tourism being one of the major industries, the airports are vital gateways and an integral part of the economy.

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The Government was advised on the deal by PricewaterhouseCoopers, a global leader in PPP advisory, with support from the international law firm, Pinsent Masons, also a lead player in the PPP sector, and EC Harris, the technical services consultancy.

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