

# PUBLIC PRIVATE SECTOR PARTNERSHIPS FOR THE FUTURE MANAGEMENT AND DEVELOPMENT OF AIRPORTS IN SOUTH AFRICA.

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## 1 INTRODUCTION

Khuthele Projects has been involved in the successful commercialization of Rand Airport (Johannesburg) and Wonderboom Airport (Pretoria). In the commercialization of both airports assistance has been provided by the Municipal Infrastructure Investment Unit (MIIU), a government established facility that supports the development of PPPs in South Africa.

Rand Airport was sold with the proviso that it should remain an airport for at least the next 20 years, and Wonderboom Airport is presently being managed under a 20-year concession contract. There are a number of regulations imposed by Government's PPP unit. That will not be dealt with in this paper. The purpose of this paper is to share some of the experiences and lessons learned by both Khuthele and MIIU through the commercialization process at these two airports.

## 2 GOVERNMENT POLICY AND THE PRESENT STATUS QUO OF AIRPORT MANAGEMENT IN SOUTH AFRICA

The White Paper on National Policy on Airports and Airspace Management, published in March 1998, states the following concerning government's policy on the management and operation of airports:

*“Where existing publicly owned airports, excluding military airports, are not financially viable and sustainable and they cannot be socio-economically or otherwise justified, every effort should be made to justify them and make them viable and sustainable. If this is not possible, alternative uses for the assets should be investigated, and could include exploiting the existing facilities for other purposes, and the partial or full redevelopment of the airport. If none of the above is possible, the closure or sale of the airport should be considered. If this is the case, the position of present users should also be considered.”*

With regard to the operation of airports, the White Paper states:

*“None of the spheres of Government should be in the business of operating airports. Therefore the involvement of the private sector in the operation of publicly owned airports should be promoted”.*

According to the South African Aeronautical Publication, issued by the Civil Aviation Authority, there are 183 licensed airports, including six military airports in South Africa. The responsible agents for these airports are:

- **Central Government:** Central Government owns 75,8 % of the shares in the Airports Company of South Africa (ACSA), which in turn owns airports in Johannesburg, Cape Town, Durban, Port Elizabeth, East London, George, Bloemfontein, Kimberley and Upington, and who also manages the Pilanesberg airport on a 35 year concession contract for the Provincial Government of the North West Province. ACSA intends listing on the Johannesburg Stock Exchange in future and Government's shares in ACSA will then be sold. The six military airfields are owned by Central Government.
- **Provincial Governments:** Provincial Governments own and manage the airports in Bisho, Mafikeng, Thohoyandou, Ulundi and Umtata.
- **Local Government:** Local Governments own 94 airports in South Africa. A number of these are managed by the private sector.
- **Private management:** Twenty three of the public airports in South Africa are managed by the private sector. The majority of these airports were previously owned by Local Governments, but have since been commercialized. Furthermore, 46 airports are licensed as private airports and permission has to be obtained from the airport manager prior to using the facility. Some of these airports were owned previously by various levels of government.

In total 57% of all the airports in South Africa are managed by the three levels of government and the remaining 43% by private sector.

### 3 FUTURE DEVELOPMENT OPTIONS

A prerequisite for the commercialisation of an airport is drafting a development plan to identify possible development options and to determine the actual commercial value of the airport. On both Wonderboom and Rand airports a limited study was undertaken to determine possible future development options.

As a typical example the following options at Rand Airport were analysed:

- Extend the airport beyond general aviation to accommodate large aircraft in future. This option would result in an increase in the traffic at the airport, which in turn would have a positive effect on the balance sheet. However, due to terrain limitations, the present allocation of airspace in Gauteng, and in particular the proximity of Johannesburg International Airport to Rand Airport, this option was not feasible.
- Retain Rand Airport as a general aviation airport and lift out, or develop, certain facilities to improve the airport's financial return. This option was partly incorporated in structuring the PPP. The main advantage of this option was that the Greater Johannesburg Metropolitan Council (GJMC), would be able to cede all contractual obligations with present airport users to the new owner. The GJMC would thus be protected against possible claims arising from the commercialization.

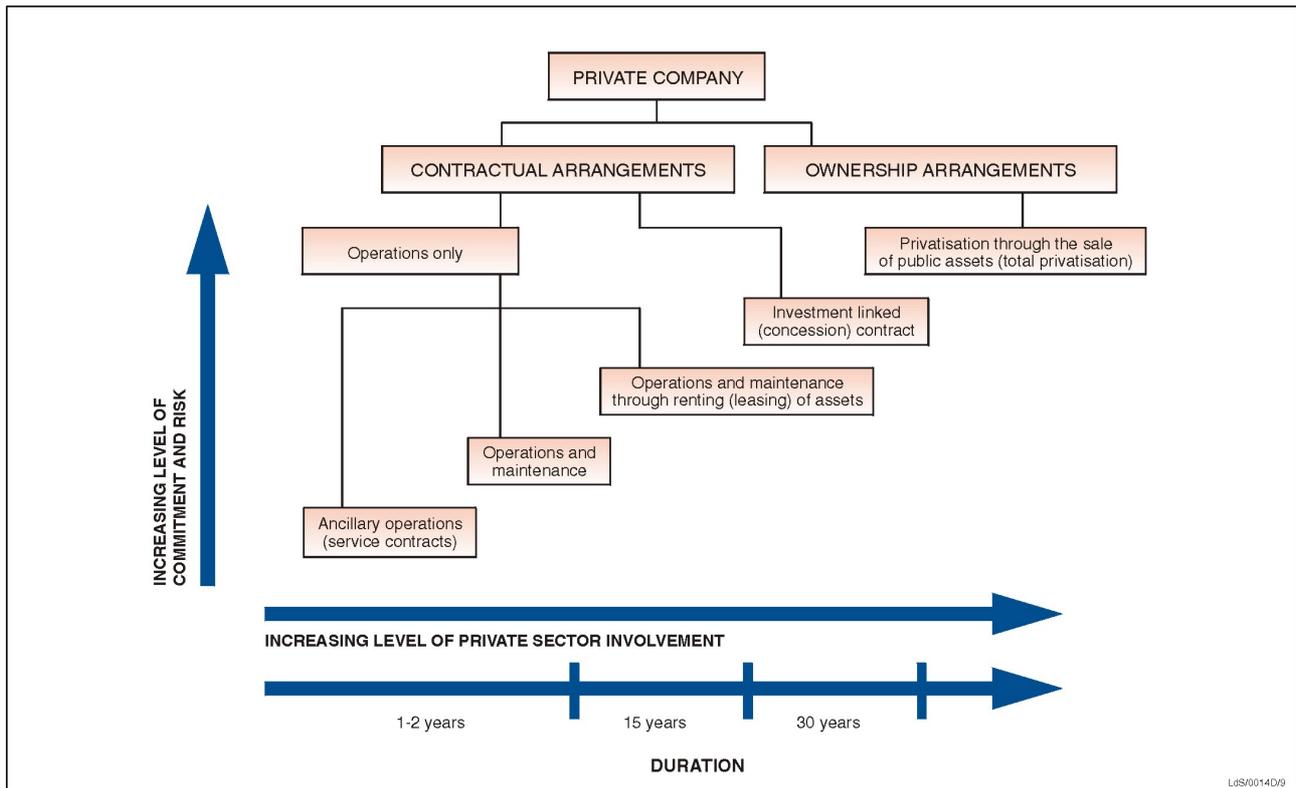
- ➔ Military usage. This option was not further considered due to the fact that the SANDF is presently scaling down their operations.
- ➔ Operate the airport in conjunction with ACSA. Airport operations at Johannesburg International and Rand airports directly influence one another. Discussions were entered into with ACSA on the possibility of commercialising Rand Airport, and to determine to what extent this commercialisation would affect ACSA. ACSA was also invited to submit an offer during the shortlisting phase, which it did not take up. If ACSA took over Rand Airport, it would have had the added advantage of solving the problem of operating two airports in such close proximity, as it would have become the responsibility of one company. The personnel would also have had the advantage that they could easily further their careers in a larger airport environment.
- ➔ Management agreement with Germiston. Although Rand Airport is located in Germiston, the GJMC was the owner thereof. Germiston City Council was contacted to determine if they would be interested in buying the airport. Germiston, however, decided that they wanted to protect their interest and therefore took up a 20% share in the airport.
- ➔ Sell excess land, but retain enough for possible airport extensions.
- ➔ Redevelop the entire property for an alternative usage. Due to the socio-economic value of the airport, which exceeded the market value of the land, a restriction was included in the sales agreement that the airport must be operated as an airport for at least the next 20 years.

A commercial value was placed on each of the options and used to evaluate whether the financial offer from the preferred bidder was adequate.

#### **4 TYPICAL FORMS OF PPP AGREEMENTS ON AIRPORTS IN SOUTH AFRICA.**

With the various airport development options known, the next phase entailed determining which form of PPP would be the most appropriate under the circumstances. In South Africa several airport owners have entered into various forms of public-private partnerships (PPPs). The Airports Company of South Africa was founded in 1993. Approximately 15 years ago, the Durban Metropolitan Council entered into a management agreement with the private sector to manage Virginia Airport. Lanseria was sold by Local Government to private sector in the 80's. Over the past few years various other arrangements have been made in this regard and the airports at Phalaborwa, Pietersburg, Pilanesberg, Wonderboom (Pretoria), Mafikeng, Rand (Johannesburg), Richards Bay, Margate, Oudtshoorn and Plettenberg Bay are some of the airports in the country which have been commercialised or are in the process of changing management / ownership.

The form of commercialisation to be selected depends on the risk / decision making power the airport owner is prepared to transfer to the private sector and the financial viability of the airport to be operated as a sustainable business. Schematically this can be indicated in the following figure:



Typical forms of PPPs in the airports industry comprise:

- ➔ Outsourcing Operations:
  - Service contracts.
  - Operation and maintenance contracts.
  - Operation and maintenance contracts through leasing the assets.
- ➔ Investment - linked (concession) contract.
- ➔ Ceding Ownership
  - Sale of shares in the airport.
  - Outright sale of the airport with certain conditions attached to the sale.
  - Unconditional sale.

#### 4.1 Outsourcing of operations

The first three types of PPPs only make provision for outsourcing of operations. Although various hybrids may exist, the most common distinctions and typical examples are:

##### 4.1.1 Service contracts

In a service contract, the private sector is not exposed to any major risks. The airport owner retains full control and the term of the contract will normally be very short. Typical examples are cleaning services, security services, garden services and air traffic control.

##### 4.1.2 Operations and Management Contracts

A very popular form of outsourcing is a management contract where the airport owner retains some control, but the management, as such, is outsourced. These terms are normally a little longer than in a service contract and typical examples are Plettenberg Bay (five year contract) and Virginia in Durban (Initially a ten year contract which was renewed for a

second term). Under these contracts the airport manager is normally paid a management fee with the owner still carrying the risk of a possible deficit.

#### 4.1.3 Operations and management with renting (leasing) of assets

The lessee pays a fee to the owner and the lessee has to carry the financial risk of the airport operation. The rent payable can either be a fixed amount per month, or coupled to the actual turnover, or a combination of the above. A typical example is the management of parking facilities at a number of South African airports. The parking operator at these facilities receives a percentage of the parking fees collected. Further examples are commercial operations such as shops in terminal buildings, which are rented out per square metre, or a fee per square metre plus a percentage of the turnover.

#### 4.2 Investment-linked contractual arrangement

Investment-linked contractual arrangements are commonly referred to as concession agreements, where the concessionaire makes a substantial investment in upgrading the facility. This is similar to a typical BOT contract (build, operate and transfer). Typical examples of such contracts are Wonderboom and Pilanesberg airports. At both these airports the concessionaire needed to invest in upgrading the runway system and is reimbursed, through income received from operating the airport. Due to the fact that the concessionaire needs to recover his investment, the contract term is normally longer than the term in “operations only” contracts. For Wonderboom Airport the concession term is 10 years with an option to renew it for a further 10 year term. At Pilanesberg Airport, ACSA has a 35 year contract.

#### 4.3 Ownership arrangements

The third group of possible PPPs includes transfer of the actual asset to the private sector. Three different forms of ownership can be considered:

##### 4.3.1 Sale of shares

The sale of shares in the airport has many advantages for the present airport owner. This can be a means of attracting capital and at the same time bringing additional expertise on board the management team. Two typical examples of the above are the sale of 20% of the shares in ACSA to Aeroporti di Roma for R819 million, and the sale of a 20% share in Rand Airport to the Germiston City Council.

##### 4.3.2 Outright sale of the airport with certain conditions attached

In this arrangement the assets are sold and the only rights the previous owner retains are the specific conditions set out in the sales agreement. Typical examples of the above are the sale of the land whereon the Pietersburg Air Force Base was developed, the land for the extension of the main runway in Port Elizabeth and the sale of Rand Airport. In the original sales agreement in Pietersburg, a clause was inserted to the effect that should the Air Force intend closing the base, Local Government will have first option to buy back the land. Later the base was closed, and the airport transferred to the Northern Province Provincial Government. The Provincial Government transformed the airport into the Pietersburg International Airport (Gateway). Presently this airport is managed by Penambang Airport Development, and Local Government still has the first option to buy back the land should the Provincial Government wish to dispose of the assets. In Port Elizabeth land was sold to ACSA on condition that they extend the runway within a certain period. In the Rand

Airport sales agreement a condition was included that the new owners must continue to operate the facility as an airport for at least 20 years.

It is thus possible to attach various conditions to a sale agreement. Care should, however, be taken not to “try and run the airport from the grave” after it has been sold. This could have an unnecessary negative financial implication on the sales price.

#### 4.3.3 Unconditional sale

Under this option the assets are sold without any conditions attached to the sale. Should the new owner wish to discontinue rendering the airport service, he is free to do so.

The advantages and disadvantages of these options were analyzed taking, amongst others, into consideration the explicit circumstances of each airport, the clients’ needs, the airport user’s needs, the financial implications of the possible PPP, and the socio-economic influence the proposed PPP could have on the community. From the analysis it was recommended to the respective councils, that Pretoria should enter into a concession agreement with the private sector for the future management and upgrading of Wonderboom Airport, and that the Greater Johannesburg Metropolitan Council should sell Rand Airport. The next step was to call for applications from interested parties, to enter into such a commercialization and address the basic issues in detail that need to be addressed in establishing a PPP.

## **5 BASIC ISSUES CONSIDERED IN THE ESTABLISHMENT OF PPP ARRANGEMENTS FOR RAND AND WONDERBOOM AIRPORTS**

The following major aspects were taken into consideration when developing the PPP package:

### **5.1 PERSONNEL**

The main reason why a number of PPP’s did not succeed in the past was due to protests by employees. Employees know what they have under the pre-PPP arrangement, but are uncertain about the future and fear losing their jobs. Typical aspects that had to be clarified included:

- ➔ Protection of employment opportunity. At both Rand and Wonderboom airports the employees were guaranteed that they would not be dismissed within a certain period.
- ➔ Freedom of association to a trade union and preferably to the existing one. It was found that the trade unions are very important for the workers and the workers for the trade union. One of the first questions asked during public meetings with employees was whether they would still be allowed to belong to their trade unions. On both projects, workers had to be transferred from Local Government to the private sector. It must be remembered that the trade union’s income is received from its members. Therefore, if the function is commercialized they will most probably lose a number of members and this will have an adverse effect on their income. Naturally, trade unions will therefore not always be too enthusiastic about the commercialization. At Wonderboom Airport this was overcome in that the concessionaire set up his organization to include the Hosken Consolidated Investments Limited representing the Mining and Textile workers as one of the shareholders. Discussions were entered into between them and the workers’ trade unions. In addition, the workers were assured of a better deal after

commercialization. Benefits that could not be honored by the concessionaire were quantified and the workers were financially compensated for these. At the end of the day, the majority of the workers received more money in their pockets than before commercialization, and were therefore prepared to resign from their former trade union. Presently the employees at Wonderboom Airport do not belong to any trade union.

- ➔ Pension. Will pension money be transferred to a new scheme, paid out, or will employees have a choice. Under these circumstances it was found that the employees preferred to receive their money. Some employees took the money with the negative tax effects, and the possibility of spending it on consumable items rather than saving it for their pension days, but the majority reinvested it in new pension schemes. It is recommended that employees be given the freedom of choice regarding their pensions but guidance should be provided regarding advantages and disadvantages of various options.
- ➔ Clarity on medical aid, who pays for what, and what will the benefits be, under the new medical scheme. Cognizance should be taken of the fact that governmental medical schemes are subsidized and the employee should be compensated in this regard to ensure that the money in his/her pocket after commercialization is at least the same as the money they took home prior to commercialization.
- ➔ Working hours, leave benefits, and additional remuneration for working uncomfortable hours. Differences may exist in the working hours the employee was used to work, prior to the PPP arrangement and thereafter. If the employee was used to 30 calendar days leave per annum and will now only receive 20 working days it should be pointed out to him in the initial negotiations. A possibility to solve the indifferences is by means of monetary compensation.
- ➔ Career development opportunities. In the new dispensation the worker should be allowed at least the same opportunities, but preferably better opportunities than those he was used to. In this way the workers attitude may be changed.
- ➔ Financial compensation. This is one of the ways where the private sector can compensate the employer for any differences between what he was used to in the former working arrangement. It was found that by offering a salary increase to the workers they were often more than willing to be transferred.
- ➔ Share ownership schemes. A further option to make the transfer less costly is to offer share ownership schemes to personnel. If an employee is offered shares in the company, he will most probable be prepared to settle for a smaller salary offer. In practice, however, the workers at the two airports were not interested in the shares and preferred cash payments.
- ➔ Possibility of redeployment in government service. One of the main motivations for establishing PPPs is to reduce the number of employees in government service. If the services are outsourced and all the employees are given the choice of being transferred with the assets, it could create a problematic situation. The GJMC had a shortage of firemen and as Germiston City Council (one of the shareholders in the new company who bought Rand Airport) was prepared to render the fire fighting and rescue service in future. The firemen were given the choice whether they wanted to be transferred. No other personnel members were given the choice. In Pretoria all the workers were given a choice and only one member remained with the service of the GPMC.

In practice it was found that employees preferred these issues to be discussed during open personnel meetings and in the presence of their trade union representatives. Regular meetings were held with personnel during the commercialization process and towards the end, individual sessions were held with each staff member. In Johannesburg the legal advice from the Council's attorneys was also made available to staff at no extra cost.

## **5.2 AIRPORT USERS**

The market served by the airport has to be protected during the commercialization phase. A loss in market share can have an adverse effect on the commercialization as the government institution might get a lower price for the asset. On the other hand positive communication can attract additional business to the airport with a potential revenue increase which in turn can have a positive effect on the market share and subsequently on the price the asset could be sold for.

The most common concern from existing airport users was the protection of their rights and all the existing contracts. At Rand Airport the majority of users founded a new company which now holds a 50% share in the airport. In order to protect the rights of those who were not shareholders in this new company, discussions were held with all the airport tenants to ensure the majority of the tenants could be satisfied. At Wonderboom Airport a clause was included in the concession agreement to protect existing contracts. An airport liaison and monitoring committee was also established to facilitate the commercialization process. This committee comprised of airport users, the concessionaire, the Metro and other interested parties living in the airport environment.

## **5.3 FINANCIAL**

Traditionally, governmental functions are provided on a service orientated basis and not on a profit driven basis. Both airports were operated at a financial deficit prior to commercialization. The local governments were prepared to subsidize the airports because the airports contributed to the economic growth of the cities. The question now arises: if a private sector operator takes over the financial risk of the operation and needs to provide the service for the term specified in the contract, what is the value of the asset? This value could be determined either from the value of the buildings plus the value of the land, or alternatively from the potential income that can be generated from the service provision.

It is of the utmost importance for the new management that the facility he / she is taking over can be operated as a financially sound business, with the incentive for the private sector partner to make a profit. If the service is sold or leased out and the capital to be paid back is too high, it will be very difficult for the new operator to run the enterprise as a commercial entity. This could result in a situation where the quality of the service declines, which could have a negative socio-economic impact. In a concession contract, if the necessary maintenance work is not carried out, the asset may deteriorate which in turn will cost the owner a lot on money once the facility is transferred back to him at the end of the concession contract. Therefore care must be taken to ensure a fair balance between the price received now, and future expectations.

At both Wonderboom and Rand airports, a financial evaluation of the business was done to determine what rental or loan could be supported from the operations.

At Wonderboom Airport the land is rented out to the concessionaire at a fixed monthly rental with the concessionaire paying a percentage of his profits to the GPMC. From the GPMC's side it is thus a win-win situation. The residents of Pretoria still have the use of the airport but the financial risk of the airport operations is now vested in the hands of the private sector. The airport will be upgraded, a necessity for which the GPMC did not have the funds, and at the same time the GPMC will receive an income from the airport. On the other hand it is also a win-win situation for the private sector. They receive the usage of all the existing airport assets and the total income derived from the airport. Secondly, they are free to carry out certain developments, which would not have been undertaken under a government dispensation. This should place them in a position to turn the airport into a financially viable business.

At Rand Airport the situation differed. Johannesburg had an asset outside its municipal boundaries operating at a financial loss. Airport users had invested millions in their hangars, which they could lose should the airport be closed. Therefore the present operators formed a company and bought out the asset.

#### **5.4 SOCIO-ECONOMIC IMPACT**

Interest groups also need to be consulted in the commercialization process. At Wonderboom Airport the community established a pressure group, the Wonderboom Airport Affected Group (WAAG) who opposed the commercialization. The main motivation of this group was that they feared that a commercialized airport might attract additional business to the airport. This will generate more aircraft noise, which in turn could have a negative effect on property values. Although the group insisted that an environmental impact assessment (EIA) be done to obtain permission for the commercialization, the Gauteng Department of Agriculture, Conservation, Environmental and Land Affairs advised the GPMC that it would not be required and the commercialization process therefore continued without an EIA. One of the conditions stipulated in the Concession Agreement is that the concessionaire should lengthen the main runway. An EIA is presently being carried out to obtain approval for the runway extension. The aspect of public consultation with possible outside interest groups is one aspect that could easily be overseen. Unfortunately this could be the link in the chain that breaks and causes the PPP to fail.

### **6 GOVERNMENT SUPPORT FOR PPPS**

These two airport projects demonstrate the considerable need for support from other levels of government in order to ensure that PPP deals are concluded successfully. One key form of support in South Africa comes at the policy level with a stable and supportive legal and regulatory framework that enables government to conclude such deals with little risk that future changes in law will make long-term contracts commercially unviable. The rationale for partnerships in South Africa is clearly grounded in various policies, which include the Reconstruction and Development Programme, the Constitution, and the White Paper on Local Government. Government's support for partnerships, and guidance on their development and implementation, is formalised in the Municipal Systems Act. Supporting activities have included the development of the Municipal Service Partnership Policy Framework, the MSP Capacity Building Programme, and the Municipal Public-Private Partnership (MPPP) Programme.

A second form of critically needed government support for local PPPs involves financial and technical assistance. Most Local Governments simply cannot find the funding in their own budgets necessary to prepare complicated, long-term projects. Many local officials also lack knowledge of or experience with such deals. Most are ill equipped to negotiate complex, 30-year contracts without a considerable amount of assistance. In order to meet this need, the government created the Municipal Infrastructure Investment Unit (MIIU) in 1998 to channel funding and technical assistance to municipalities that need help in developing PPPs.

The MIIU is a not-for-profit company established with international aid donor assistance to facilitate the preparation of PPPs in several sectors, including municipal airports. The professional project staff of the MIIU is led by a small team of international and domestic PPP experts supervised by a government-appointed CEO and Board of Directors. The MIIU manages a grant fund capitalised by the National Government. The money is allocated to Local Governments to allow them to hire experts from the South African consulting and investment community to assist with feasibility studies, project packaging work, as well contract negotiations. MIIU's project staff provides local officials with guidance regarding (1) the conceptualisation and design of PPP projects, (2) the selection, supervision, and evaluation of local consultants tasked with preparing feasibility studies and bid document packages, (3) the negotiation of PPP contracts, and (4) appropriate means and methods for interacting with national level stakeholders, such as labour unions and relevant national government ministries.

Since the creation of the MIIU in 1998, the unit has assisted in completed PPP projects of all kinds in total worth over R5 billion in sale proceeds and/or capital investment. In addition to assistance and/or funding provided in support of the Rand Airport project and the Wonderboom Airport projects, MIIU has also supported airport concession contracts in Richards Bay and Margate.

## **7 CONCLUSION**

It is trusted that the experience gained in the commercialisation of Wonderboom and Rand airports will assist others who are presently commercialising facilities traditionally run by government. However, it is not an easy process and there are no fixed recipes. Public partners in such deals, along with their transaction advisors, must remember several key points: (1) all stakeholders must be consulted as the deal move forward, especially employees and users, (2) expectations about the value of assets must be kept realistic, and (3) restrictions imposed on the private sector partner regarding how the facility must be operated after commercialisation will be priced into the deal by the private partner--the more restrictions imposed, the lower the financial return on the deal for the public partner.

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Laumi de Swardt grew up in Pretoria and obtained his Bachelors degree in Civil Engineering from the University of Pretoria in 1979 and a MBA in 1985. Laumi started his career as civil engineer in 1979 at the consulting engineers KBK. At KBK he gained experience in road design and the provision of municipal services especially in previously disadvantaged areas. In 1985 he joined the former Development Board of Central Transvaal to set up the engineering department for the City Council of Mamelodi, which was at that stage the third largest black city in South Africa. He served as City Engineer in Mamelodi for a period of two years. In this term the first major private sector financed, housing development in South Africa, consisting of 1168 houses, was build in Mamelodi. After his term in Mamelodi he was promoted to Director Technical Services at the Transvaal Provincial Administrations' Department Community Services, where he was responsible for infrastructure developments and housing schemes in Soshanguve, Lethlabile, Ekangala, Refilwe and Zithobeni. In 1988 he joined BKS Consulting Engineers. At BKS he started specializing in airport developments and worked in 11 Sub-Saharan Countries for BKS. In 1998 he was one of the founder employees of Khuthele Projects (Pty) Ltd, a consulting practice with a majority black ownership and directorship. Khuthele Projects was responsible for the commercialization of the Wonderboom and Rand airports, and assisted others in the commercialization of Richards Bay and Margate airports. Salient points from these projects are described in this paper. Presently, Laumi is full time engaged in the master planning of the major regional airports in Botswana, as a subconsultant for a joint venture between BKS Global (Pty) Ltd and TTCS Consulting Engineers a major Botswana consulting engineering practice. One of the elements of this study, includes developing a financial sustainable basis for the establishment of an autonomous Civil Aviation Authority in Botswana.