GREENFIELD PROJECTS SPELL RED INK FOR FINANCIERS

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The federal government has announced that the Western Sydney Airport at Badgerys Creek is going ahead. That's great — it's needed and will benefit a whole host of stakeholders. But who's going to pay for it?

Major greenfield airport developments come with significant upfront construction and operational costs and the use of the available capacity which generates vital revenue flow builds slowly over time.

It's demand based economic infrastructure and there will be plenty of banks and investors who will remember the pain that developing and operating such infrastructure can entail. Think of some other recent high profile Australian demand-based infrastructure projects — all those tunnels; Cross City, Lane Cove, North South Bypass, Airport Link. For the original financiers and investors, it didn't end well.

So why does a greenfield airport project present similar characteristics to these failed projects? To borrow from the movie Field of Dreams, "if you build it they will come". In the case of the Western Sydney Airport — that's almost certain to be true at some point, but the difficulty is, you don't know exactly when they will come, you don't know how many of them will come and you don't know how much they will be prepared to pay when they do come.

That leads to uncertain revenue projections and revenue flows in the early years of the airport's operations. This in turn means that project finance, which is generally competitively priced bank debt used for funding major projects, can be very difficult to attract for greenfield demand based economic infrastructure projects. The banks will have a quite legitimate concern that there may not be sufficient revenues available in the early years of the airport's operations to meet debt service obligations. When that happens the same default scenario presents as was the case confronted by the tunnel projects noted earlier.

Equity is expensive so the more reliant you are on equity, the greater the cost to the project and drain on available revenues. It is only part of the answer. Bonds can be good but bond holders are likely to have similar concerns to the banks and best of luck getting an IPO away to develop a demand based economic infrastructure project.

If recent pronouncements are of substance, it is probably also a reasonably educated guess to assume that Sydney Airport Corporation will not exercise its option to develop the new airport. Corporates and institutions who have the balance sheets to directly fund the development would not be prepared to accept the development risk associated with the early years of the project.

We have seen from other major airport developments that the main users of the new airport — the airlines which in this case, based on recent comments by Alan Joyce, are likely to be low cost carriers such as Jet Star and Tigerair — are very unlikely to make any long term commitments as to usage and an associated payment to support upfront development costs.

And if the Western Sydney Airport is positioned as an airport for use predominantly by low cost carriers, there is also another characteristic of such airports — passenger spend is usually less per head than that at airports servicing full service carriers. All of this leads to a funding headache for the Western Sydney Airport.

So where to from there? There is bipartisan support for infrastructure spending which stimulates economic activity and boosts productivity. The Western Sydney Airport is critical infrastructure that needs to be built. Once the airport has been developed and has operated for a sufficient period of time, the funding picture and the institutions that would be prepared to take an ownership stake is likely to change.

For example, many of the major superannuation and pension funds are likely to be at the head of the queue. To reach this point, there is a case to be made for government funding or underwriting of some or all of the initial development costs. The initial development could take place in stages — runway and terminal for example with the broader precinct to follow, on the understanding from the outset that the asset and/or key operating rights would be sold down to recover the government's development or underwriting costs.

There are a host of combinations of development, funding and operating models available involving government and private sector participation which would achieve the desired outcomes. Some may also include direct or indirect assistance from the state government. What is clear is that once the usage profile and revenue generated by the airport has been reliably established, a significant payday would likely await the government upon sale with key transport infrastructure assets currently attracting multiples as high as 25 times EBITDA. Jeremy Prentice is a partner at global law firm K&L Gates where he specialises in airport and port developments.