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AIRPORT DEVELOPMENTS INDONESIAN ARCHIPELAGO

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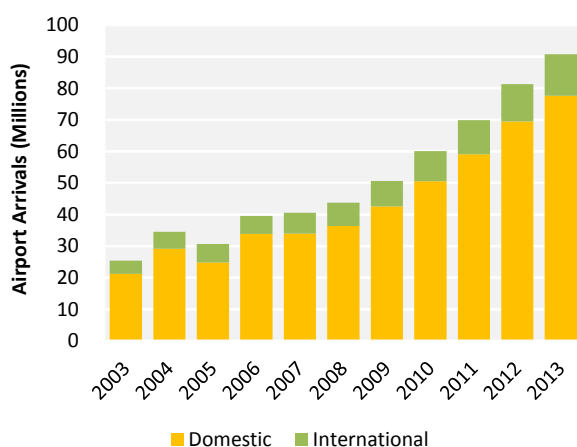
Introduction

Airports are vital to economic development – including tourism destinations – particularly in the case of island nations such as Indonesia. As the largest archipelago in the world, Indonesia spans a distance of over 5,300 kilometers, from the westernmost province, Aceh to the easternmost, Papua – almost the distance of London to New York. The country is made up of 17,508 islands, one third of which are inhabited. The importance of air transport for economic progress is ever more heightened when only a handful of cities can be connected by land. A strong transport infrastructure has a direct impact on the progress of economic growth and socioeconomic development for the country.

Current Situation

As of March 2015, there are 237 operating airports in Indonesia connecting its 34 provinces and 17,508 islands. Angkasa Pura I and Angkasa Pura II, both limited-liability state owned companies operate 13 airports each; the remaining airports are under the management of the Ministry of Transportation's (MOT) Directorate General of Air Transport. In order to address the growing demand for increased air connectivity, in October 2014, the Ministry of Transport announced its intent to finance the construction of 165 airports in various cities in Indonesia.

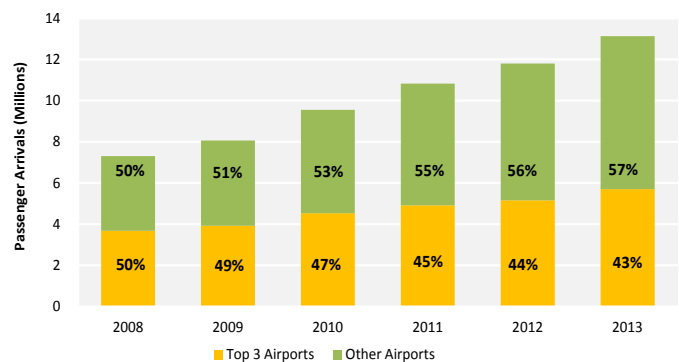
FIGURE 1: TOTAL INDONESIA AIRPORT ARRIVALS 2003 - 13



Source: BPS Indonesia

In the decade between 2003 and 2013, total airport arrivals to Indonesia grew at a Compound Annual Growth Rate (CAGR) of 13.6%, driven by the strong growth of domestic travel (which has nearly quadrupled in ten years). In gateway markets such as Bali domestic arrivals grew from an estimated 1.9 million in 2008 to over 4.5 million in 2013. International arrivals to Indonesia have also shown strong growth of 212%, from 4.2 million in 2003 to 13.1 million in 2013.

FIGURE 2: INTERNATIONAL ARRIVAL PERFORMANCE, TOP 3 AIRPORTS



Source: BPS Indonesia

Currently Soekarno Hatta (Jakarta), Ngurah Rai (Bali) and Kualanamu (Medan) are the three busiest international airports in Indonesia. In 2008 the top three airports serviced 50% of total international arrivals, indicating that half of international visitors to Indonesia were obliged to transit through one of these airports (unless it was their end destination as is likely for arrivals to Bali). With these airports rapidly reaching capacity – by some estimates Soekarno Hatta operates 200-300% over capacity – allowing access to other airports for international routes became increasingly important. In 2013 43% of international arrivals were handled through these three airports, indicating that this shift to other gateways is underway. In late 2014 the government announced that 103 airports will undergo renovations over the coming years and 29 will be outfitted to handle international arrivals.

Factors Driving Development

ASEAN Economic Community (AEC) aims for regional economic integration by the end of 2015. The agreement would transform ASEAN into a single market and production base, with the goal to spur economic development and global competitiveness. The initiatives outlined would reduce barriers between ASEAN members for the free movement of goods, services, investments, skilled labour and flow of capital.

From the AEC emerges another initiative to improve regional connectivity: the ASEAN Single Aviation Market (ASEAN-SAM). This open skies agreement aims to deregulate the airspace within ASEAN, removing restrictions and allowing airlines to transit across national airspaces under a single unified air transport agreement. Indonesia has been hesitant to completely liberalise their airspace with domestic carriers lobbying against the move. Under the agreement access points are expected to be Soekarno-Hatta International Airport (Jakarta), and airports in Surabaya, Medan, Makassar and Bali; other airports will be subject to bilateral agreements and foreign airlines will still not be permitted to service domestic routes.

Improving national connectivity has been highlighted as a key pillar of the government's Master Plan for the Acceleration and Expansion of Economic Development 2011 – 2025 (MP3EI), announced in May 2011. Six economic corridors - Sumatra, Java, Kalimantan, Sulawesi, Bali and Papua - have been identified as priorities for economic development. In 2015 the MOT released an updated plan on infrastructure development in Indonesia, outlining locations of new airports, as well as the development plans for maritime and land connectivity. With key airports operating well above capacity in 2014, the issue of developing national airport infrastructure has reached a peak.

The Public Private Partnership Scheme (PPP) is one avenue geared towards supporting airport developments. Under this scheme the government will support the private sector with various incentives¹ (tax incentives, fiscal contribution, government guarantees, etc.) to increase investment appeal and reduce the associated risks involved in airport developments. Various structures to the PPP are available depending

on the economic and financial viability of the development. There are currently ten airports under this scheme open for tender by the MOT, to be managed by the private sector. Bandar Lampung's Radin Inten II Airport, Palu's Mutiara Airport and Komodo Airport were the first three airports open for tender. The other seven airports includes Fatmawati (Bengkulu), Hananjoeddin (Tanjung Pandan), Tjilik Riwut (Palangkaraya), Juwata (Tarakan), Sultan Babullah (Ternate), Sentani (Jayapura) and Matahora (Wakatobi). PT Indonesian Infrastructure Finance (IIF)² highlights that airports under this scheme need to have more than 500,000 annual passenger arrivals, traffic growth more than 5% per annum potential to support economic growth and clear status on land/asset ownerships. Komodo Airport and Matahora Airport, however, seem to be exceptions to the criteria mentioned by IIF, as both airports do not fulfill the required passenger volume.

PT Garuda Indonesia, Indonesia's national carrier, has expressed interest in operating Komodo Airport in Labuan Bajo, East Nusa Tenggara. The airport would allow greater access to the Komodo National Park, declared a UNESCO World Heritage site in 1991 and New Seven Wonders of Nature in 2011; in 2013 Komodo received 89,154 airport arrivals, a growth of 27.5% from the year before.

Bandar Lampung is the capital of Lampung Province and acts as the main gateway city of Sumatra connecting Java and all other provinces. Bandar Lampung is the main entry point for tourists interested to visit various national parks of Sumatra. Estimates indicate that passenger arrivals to Bandar Lampung's Radin Inten II Airport reached approximately 1 million in 2014³.

Palu, the capital of Central Sulawesi, is dependent on Lindu National Park, a UNESCO Biosphere Reserve, acting as its primary tourism demand generator. Palu is also often used as a transit point for passengers heading to Tenjung Karang in Selangor, Malaysia. Palu's Mutiara Airport received nearly 500,000 passenger arrivals in 2013, accounting for 84% of all passenger arrivals to Central Sulawesi.

¹ Presidential Regulation No. 56/2011 and Minister of Finance Regulation No. 223/2012

² Private non-bank financial institution formed by and under the Ministry of Finance

³ Bambang Tjahjono Airport Director of the Transport Ministry mentioned in an interview with Jakarta Post.

Factors of Concern

Tight Regulation – Airlines

Amongst other regulations, there is a price ceiling/floor imposed on all domestic routes⁴. Full service airlines on these routes can charge 100% of the regulated price whilst medium service can charge 90% and low cost carriers up to 85%. Furthermore, low cost carriers cannot price tickets lower than 40% of the price ceiling. This policy has drawn much criticism particularly with the budget airlines whose competitive business model is contingent on flexible pricing. The proliferation of regional low-cost carriers is one of the factors underpinning the strong growth in regional travel; a pricing policy that works against their business model may stifle the growth of remote tourism destinations before it even begins.

Legislative Constraints – Developers

In June 2014 further legislation came into effect to support the PPP model for airport development and eliminate previous conflicting regulation.⁵ The new regulation provides clearer guidelines for airport developers on the application of ministerial consent. The main limiting factor that legislation failed to address, however, is that developers must obtain approval from the local authorities, including the national government's own initiatives. Proposed developments are assessed by the local government based on its match with the regional economic development plan, which may at times be in conflict with overarching national plans. The stuttering development of national government initiated Karawang International Airport (KIA), located east of Jakarta, illustrates the weakness of this legislation. When operational, KIA will be in direct competition with the current, West Java government initiated, Kertajati International Airport. The competitive nature of KIA had made the government of West Java hesitant to issue approvals for its development. Constraints of the regulation are further aggravated by the local politics and opposition parties. If not addressed, the lack of decisive direction on this issue may be a major factor hampering airport development.

⁴ Minister of Transportation Regulation No. 51/2014

⁵ Minister of Transport Regulation No.20/2014

Air Safety Concerns – Passengers

IATA has expressed strong concern on aviation safety within the Indonesian archipelago. The International Civil Aviation Organisation's (ICAO) Universal Safety Oversight Audit Program (USOAP) found Indonesia to be below the global average. Other organisations such as the US Federal Aviation Administration downgraded Indonesia to Category Two in its International Aviation Safety Assessment Program. Indonesian airline safety came into the spotlight in 2014 with the United Nations urging the country for improvements for both the airlines and ground airport infrastructure. This remains a concern for the development of new air routes serving new tourism destinations due to the safety perception of passengers, particularly related to domestic carriers. If not addressed, destinations dependent on the airlift may not realize the intended number of passenger arrivals.

Over Capacity – Other Stakeholders

Several major airports such as Soekarno Hatta International Airport and Juanda International Airport are currently running an estimated 200 – 300% over capacity. With IATA forecasting air passengers within Indonesia to increase by more than 183 million by 2034, the current situation is not sustainable. The capacity constraints are at all levels from runways to terminals, and create issues for airline operations, flow of passengers through the airport and traveler amenities. The constraint at the major entry points may cause a ripple effect to other destinations, which are not serviced by international carriers or routes, and dependent on visitors transiting through a gateway onto a domestic flight to finally arrive at their destination. The constant strain on the airport infrastructure may bring about limitations to much required maintenance, overcrowding within the airport terminals, and servicing that could result in further safety concerns.

Skilled Labour

With a potential surge in the number of airports and more crowded air traffic corridors over the next five years, airlines and airport operators face the challenge of a potential skilled labour shortage. The need for well trained and qualified pilots, engineers, traffic controllers, ground staff, including border control for new international airports, will heighten.

Compromising on safety and the resources to ensure this is not an option, this likely labour shortage may slow the opening of new airports.

Airport Expansion Highlights

With a growing demand for travel to Indonesian cities far exceeding current facilities, there is an imperative need to expand the capacity of existing airports. With potential roadblocks threatening the slow down of airport development, the national government is also emphasising the expansion of existing nationally-owned airports to ensure their ability to handle the growth in future passenger arrivals.

Spota Rokot Airport – Mentawai Islands

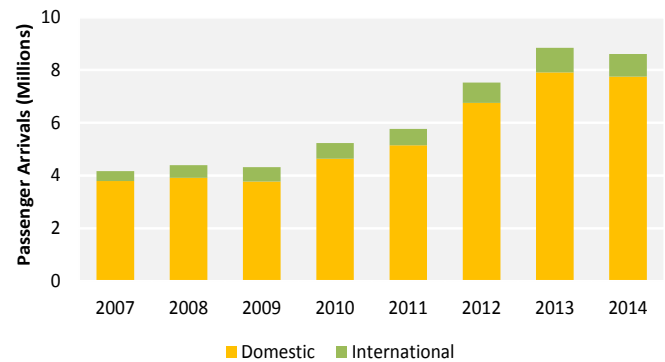
Mentawai Islands are a collection of approximately 70 islands to the west of Sumatra, facing the Indian Ocean. Currently Spota Rokot Airport is the only airport and can service only small seven to ten seater aircrafts. Expansion plans include a new 1,400m runway to handle larger aircrafts (100 passengers). The cost of the expansion is estimated to be between Rp 400 billion to Rp 500 billion (US\$31 – 38 million) and will be borne by the local government of West Sumatra. Siberut, the largest island within Mentawai, is a UNESCO Biosphere Reserve and known for the Siberut National Park and the cultural heritage of the indigenous Mentawai tribe. Mentawai is also fast becoming a popular surfers destination, despite – or because of – its relative inaccessibility. At present the Mentawai Islands are accessible via Padang. The journey from Jakarta to Mentawai involves a two hour flight to Padang, one hour taxi ride to Bungus Port and finally a 10-hour ferry ride to the islands, alternatively a flight on a small 10-seater aircraft from Padang.

Juanda International Airport – Surabaya

Surabaya's Juanda International Airport has seen strong growths in passenger arrivals in recent years with CAGR of 13% between 2010 and 2014, reaching 8.6 million passengers in 2014. Surabaya is the capital city of East Java and second largest city in Indonesia. In order to keep up with the growing demand, Angkasa Pura I plans to expand Juanda with three more runways by 2017. According to the airport, construction has yet to commence. Surabaya is the nation's commercial hub for the eastern region of Indonesia with one of the country's busiest seaport.

Marine and shipbuilding, industrial automation, vehicle manufacturing, energy production, plastic and packaging industries are the mainstays of the city's economy driving demand for the expansion of the airport; East Java contributes 14.9% to national GDP.

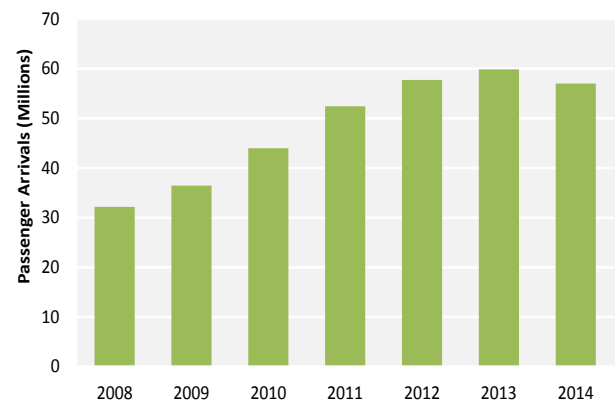
FIGURE 3: JUANDA INTERNATIONAL AIRPORT ARRIVALS 2007 - 14



Soekarno Hatta International Airport – Jakarta

According to the Airport Council international (ACI) Traffic Report, Soekarno Hatta International Airport is one of the three busiest airports in Asia Pacific. Total passenger arrivals to Soekarno Hatta have grown at a CAGR of 7% between 2010 to 2014. Foreign and domestic arrivals in 2014 were approximately 2.3 million and 55 million, respectively having grown by 53% and 78% since 2010. Growth has slowed in the recent years, mainly attributed to the worsening congestion at the airport's various terminals (both for airlines and passengers). In a bid to ease traffic, plans are underway to build third runway and expand the airport's three terminals. As of January 2014, selected commercial flights have been rerouted to Halim Perdanakusuma Airport, to the West of Jakarta.

FIGURE 4: SOEKARNO HATTA INTERNATIONAL AIRPORT TOTAL PASSENGER ARRIVALS 2008 -14



Airport Pipeline Highlights

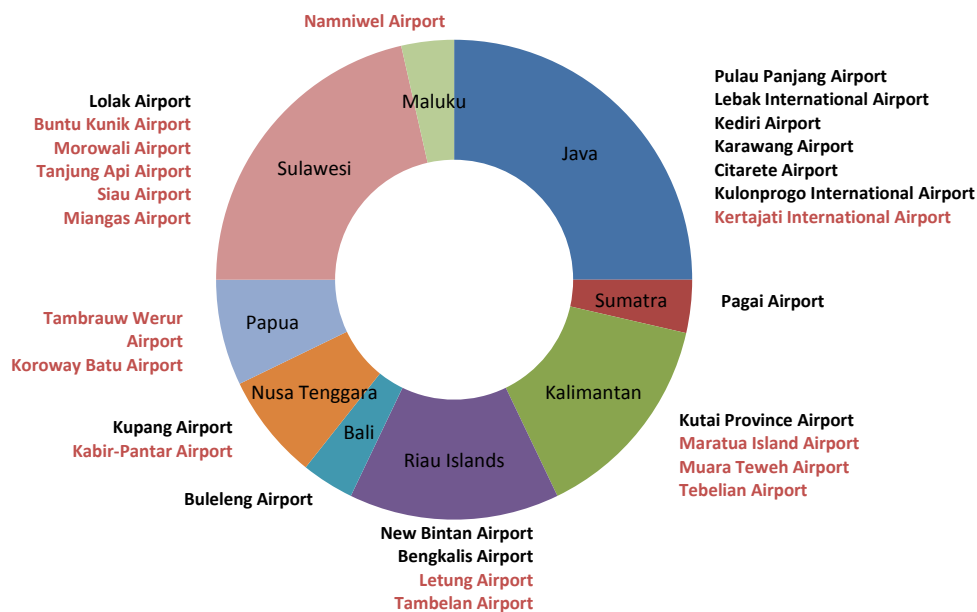
The Indonesian government intends for airport developments to have a service area at a radius of 100 kilometers for the airports in Java and Sumatra; 60 kilometers for Kalimantan and Sulawesi and 30 kilometers for Maluku, Nusa Tenggara and Papua. Figure 5 presents the distribution of 28 potential airport development sites. New airport locations (highlighted in red) were outlined during the government's Infrastructure Forum in April 2015. The remaining 12 airports are known to be at various stages of development.

Bintan. The success of new large scale developments on the island (in the Special Economic Zone) will depend on airlift and improved connectivity to source markets. Total airport arrivals to Bintan Island have grown at 11% CAGR between 2009 and 2013 to reach an estimated 240,000 according to CAPA.

Lebak International Airport – Banten

Lion Group, parent company of budget airline Lion Air has obtained approval to commence construction on a new airport in Banten, southwest of Jakarta. The site

FIGURE 5: INDONESIA PIPELINE AIRPORTS



Source: CAPA - Centre For Aviation, Ministry of Transport, ACI

Bintan Airport – Bintan

The new airport expected to commence operations in 2016, located in Lobam close to the Industrial Estate and Free Trade Zone, is a partnership between Garuda Indonesia and Singapore-based Gallant Ventures. The new airport aims to improve connectivity between East and West Indonesia as well as other international destinations through Garuda's network of flights. The Garuda dedicated airport will be connected by ferry to Singapore and thus draw on demand travelling to east or west Indonesia. This highly anticipated development is expected to spur tourism development on Pulau

for the new airport is approximately 4,000 hectare, roughly twice the size of Soekarno Hatta International Airport. Plans include four runways, one of which able to handle an A380, enabling the airport to cater to long-haul flights. Lion Group's CEO Rusdi Kirana has the intention to develop the new airport as a multimodal hub, of the domestic cargo market, for the region. Currently there are plans for a commercial centre and integrated rail links to the new airport.

Kutai Province Airport – Loa Kulu

East Kalimantan with an area of 200,000 km² is currently served by three airports: Samarinda International Airport, in the east and two other smaller domestic airports in Long Lunuk (North) and Balikpapan (South). In 2013, East Kalimantan received 3.6 million airport arrivals having experienced a growth of 29% since 2009. According to CAPA, the new Kutai Province Airport, located further inland in Loa Kulu, aims to be the gateway for international tourism to the region. This development is in line with the national government's economic master plan to accelerate economic development in six economic corridors, with Kalimantan becoming the center of production and processing of national mining and energy reserves. East Kalimantan is known primarily for its pristine rainforest, the highlight for the many nature enthusiasts who visit the area. Besides nature based activities, the rich cultural heritage of the indigenous Dayak tribe is also a popular draw.

Outlook

With only 237 airports, 6,000 inhabited islands, a growing economy and population, along with strong growth in tourism arrivals, the need for a solid transportation network is vital for Indonesia to maximise on the tourism opportunities ahead.

The urgent need to improve connectivity within the country has been identified and the government has formulated economic plans to chart this. However the legislation required to support these initiatives is lagging, hampered by disparities between the various stakeholders interest.

Beyond confusing legislation other challenges persist. The reliability and safety record of the domestic airline sector is a key pillar to the success of this initiative. In the absence of this, traveller confidence in domestic carriers will wane, with travellers preferring international carriers and ultimately visiting destinations served by these airlines.

With a wealth of pristine natural reserves, diverse cultural heritage, remote islands and deserted beaches, Indonesia faces a tremendous opportunity in developing new tourism destinations, which is often the first step towards economic progress in local communities.



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