Infrastructure Finance

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Infrastructure Sector in India

- Infrastructure sector is a key driver of any economy - Spending 1% of GDP on infrastructure likely to boost Indian economy by 2% (S&P Global Study).

- Till late 80s and early 90s the infrastructure sector was totally under Government, through budgetary support and projects were awarded through EPC route. However this was not sufficient to address growing need of infrastructure sector.

- A thrust of PPP model of Infrastructure Development was initiated in late 1990s and the sectors started opening for Private sector since early 90s.

- With the growth in Indian economy at the range of around 7%, it has also exposed the grave inadequacies in the infrastructure sectors. The policy making bodies has acknowledged that the state of the infrastructure is a drag on the economy, perhaps by as much as 1 to 2 per cent a year.

- Despite significant development quality of Infrastructure in India still lags behind several economies – India ranked 37 among 63 economies on World Competitive Index 2022, published by Institute of Management Development (IMD).

Current Scenario and the future prospects

- The total infrastructure credit by banks and NBFC-IFCs is estimated at ₹24.7 lakh crore as on June 30, 2022 (Banks: Rs. 11.5 Lakh Cr, IFCs: Rs. 12.9 Lakh Cr, IDFs: Rs 0.3 Lakh Cr). The share of IFCs in the total infrastructure credit continues to increase and stood at 54% as on March 31, 2021. At the same time, the share of banks has continued its decline to 46% from about 61% five years ago, on the back of subdued lending to the sector..

- The growth in FY21 was mainly supported by NBFC-IFC's, which grew by 16% while banks, which have been the major financiers to the sector over a long period are seen stepping back, and grew by 4% in the infrastructure financing space.

- As for sectoral exposures, the power sector (including renewable and transmission segments) continues to dominate the overall portfolio mix for banks and the IFCs, Exposure to the power sector (including the renewable and transmission segments) continues to dominate the overall portfolio mix of banks and IFCs, accounting for 58% of their total loan books as on March 31, 2021. However, this share is gradually declining with the increasing share of other infrastructure sectors. Other substantial exposures remain to the roads (12%), Railways (14%+) and telecommunications (5%) sectors.

Current Scenario and the future prospects

- Given the nature of infrastructure financing, the ticket size of loans remains large, exposing these entities to concentration risk and hence asset quality-related shocks. However, the asset quality over the past three years has improved for IFCs, led by a growing asset base, resolutions/ recoveries of a few stressed assets, sizeable write-offs and lower incremental slippages.

- Despite the challenging environment in FY2021, most infrastructure sub-sectors remained resilient from a debt-servicing perspective. With the improving asset quality and increased provision cover against non-performing advances, the aggregate solvency indicator has improved considerably over the past two years. With the balance sheets recovering, the sector is placed relatively better for growth.

- Meantime, Government has set an ambitious target of infrastructure investment of over Rs 111 trillion under the National Infrastructure Pipeline (NIP) over FY2020-FY2025, as also a large monetisation targets announced recently.

Current Scenario and the future prospects

- Thus, the medium-term growth prospects for the NBFC- IFCs remain strong, with demand expected to gather pace amid the government's resolve to revive economic growth. The expected pick-up in demand is likely to coincide with a recovery in the balance- sheet strength of NBFC-IFCs and their improved ability to raise relatively longer-term funding at competitive rates amid the favourable systemic rates trajectory.
- However as per NIP Report, the existing sources would be able to finance 83-85% of capital expenditure, of which some portion (6-8%) can be filled through new DFIs and asset monetisation to monetise operating assets.

INFRASTRUCTURE FINANCE – SPECIAL FEATURES

- Long Life
- Large Investment
- Immobile
- Local Currency Revenue
- Higher Debt Equity Ratio
- Major role/stake of Government and hence vulnerable to Regulatory Changes
- Politically Sensitive Tariff
- Service is quasi public good and hence full cost pricing may not be feasible
- Non Recourse Financing

INFRASTRUCTURE FINANCE – IMPORTANT POINTS

Infrastructure Finance	Project Risks are identified and clearly demarcated and allocated to the relevant stakeholder who has the best ability to bear any particular risk.
	More importance to cashflows as security (TRA)
	Transparent Regulatory Framework

Project Appraisal - Highlights

- Acceptability of the Proposal now varies by each Institution's Lending Model

- Each Institution has its own Appraisal format but the basic parameters are similar.

- It is a second look at the project from Lenders' perspective. Analysis of risks and the mitigants available.

Appraisal process

- Identification of Risks in Project
- Assessment and Quantification of Risks
- Possibilities of mitigations of the identified risks and mitigants
- To decide on acceptability of the project and pricing of the residual risk.

Risks in Infrastructure Projects

- **Risks in Development Phase** – Very High risk. Only equity capital is used
- **Risks in Implementation phase** – High Risk, require large volume of finance. Mixture of equity, sub-debt, senior debt, guarantees used
- **Risks in Operations phase** - Lower risk. Refinancing (with bonds internationally) is possible

Risks for infra projects

- Sponsor - Equity Commitment,
- Market – Take or Pay (PPA). Traffic study (with single purchaser then there is Payment Risk)
- Inflation – Index linked tariff
- Currency – Hedging, exchange indexed tariff
- Force Majeure – Insurance
- Regulatory Risk – Govt. support with stable and transparent regulations and independent regulator
- Country Risk – Host Country
- Political Risk – PRI
- Legal Risk- Whether legal system can handle the complexity of the project structure

Risks for infra projects (cont.)

- **Construction Risk** – FTFP contract with adequate LD, Contingency provision in cost, start up insurance
- **Completion Risk** – By EPC contractor with adequate guarantee, LD provision
- **Completion Test** – On time, within budget & cashflows as per the projections
- **Fuel Risk** – Pass through structure, long term supply contract
- **Technical Risk-** O&M Contractor

Environment Risk

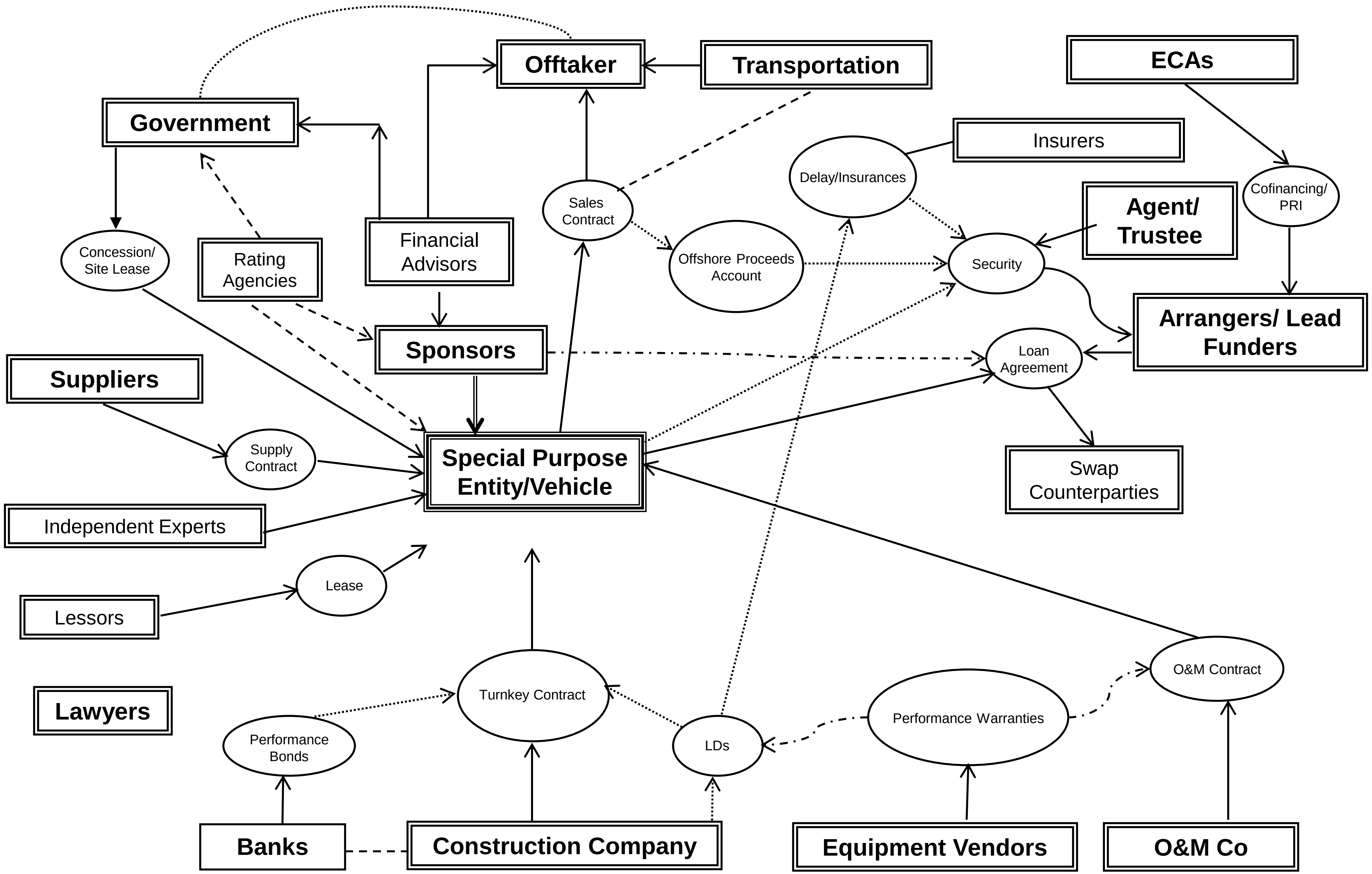
- Environmental hazards and accidents
- Violation of environmental regulations
- Resettlement and rehabilitation of population

Role of Government in Infrastructure

- Policy Maker
- Regulator
- Concessionaire/ Developer/Operator ?
- Concession Agreement
- PPA

<u>Conflict to be avoided</u>

- Govt. to be in policy making.
- Regulator to be independent
- Regulation to be transparent and independent



Deal Diagram of Infra Projects

Trust & Retention Account (TRA)

- Difference with escrow account
- Waterfall arrangement
- Permitted Investment

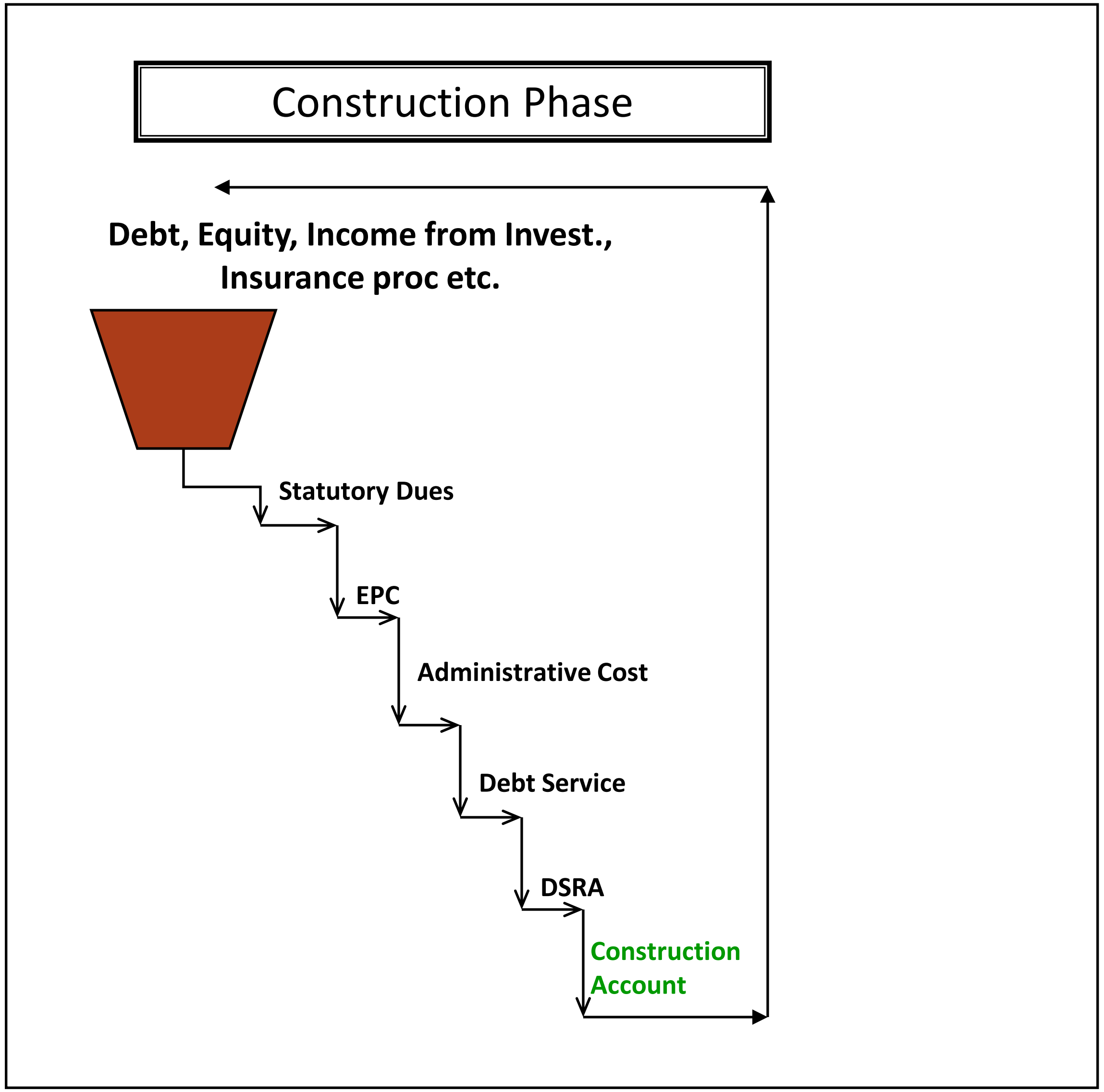
<u>Construction Phase</u>

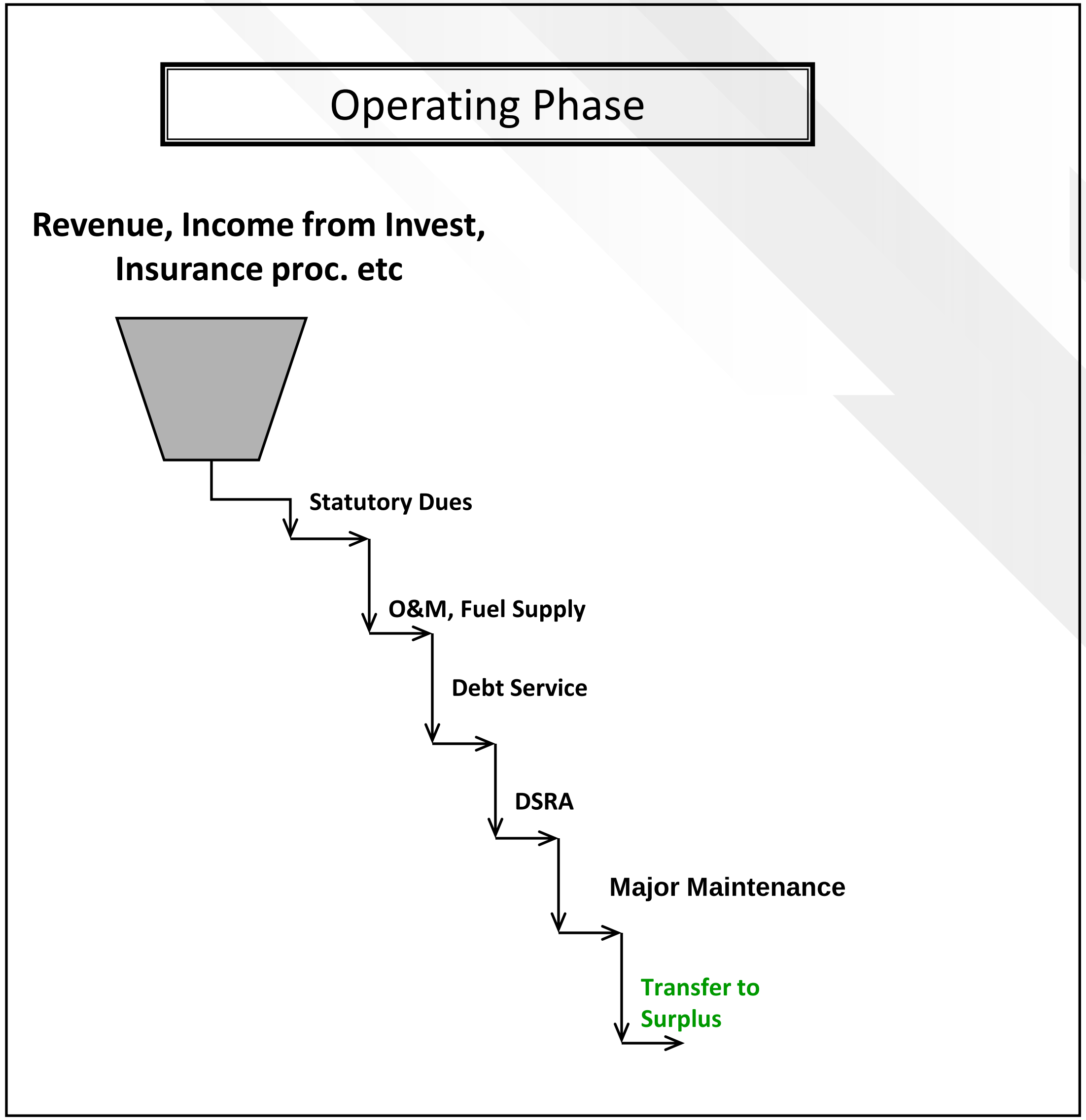
- Inflows – Debt, Equity, Income from investment, subsidy, insurance proceeds
- Outflows – Statutory dues, payment to EPC, Administrative cost, Debt service, DSRA

<u>Operations phase</u>

- Inflows – Revenue, Income from investment, subsidy, insurance proceeds
- Outflows - Statutory dues, O & M and Fuel cost, Debt service, DSRA, Major Maintenance, Surplus account

Waterfall Mechanism in TRA





Challenges & Key Focus Areas

- RBI had earlier underscored the need for diversified financing options and targeted push on public investment and NIP and some large new projects like high speed rail, that can ignite the economy.
- Funding for these projects can be done through monetization as already taken up by Govt in National Monetisation Plan (NMP).
- Further augmentation of capital requirement is to be done through capital market and FDI. ***(InvITs have become a major vehicle for FDI in Infrastructure sector)***
- Promotion of Corporate Bond Market for providing Long Term Funding of Infrastructure projects.

Issues to be resolved

<u>Issues needing Correction/Resolution by Govt/Regulator/Concessioner</u>

- To streamline Regulations with international best practice
  - Allow Relay Financing or refinancing of Infrastructure projects with adequate residual concession period (eg. Channel Tunnel Project of British and French Govt)
  - Delink Asset classification with COD date in for Infra projects with substantial (say 85%) project progress.

- To streamline Long drawn dispute resolution process and shorten the time.

- To ensure early release of Termination payment by Concessioning Authorities like NHAI.

- Delay in land acquisition and approvals & clearances also need to be resolved by Authorities

- New upcoming sectors like EV, Hydrogen need to be given Infrastructure status, for facilitating sustainable development..

THANK YOU

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