Capacity Building in Infrastructure Financing

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Rationale for PPP Projects

- Availability of quality infrastructure is a pre-requisite for broad-based and inclusive growth on a sustained basis.
- Given the enormity of the investment requirements for physical infrastructure - imperative to explore avenues investment in infrastructure through a combination of public investment.
- Recognizing the definitive role of private sector to meet the infrastructure gap and the role of PPPs, concerted effort to develop the PPP Program and mainstream PPPs activities.
PPP Projects-Implementation Issues

- Global experience- PPPs work well when they combine the efficiency and risk assessment of the private sector with the public purpose of the Government sector.
- Problems arises when they rely on the efficiency and risk assessment of the Government sector and the public purpose of the private sector.
- One should be careful not to undertake PPPs that do not apportion risks and responsibilities sensibly.
PPP Projects-Implementation Issues

- Flexibility needs to be built into arrangements so that the contract can be withdrawn and put up for rebid when the private party underperforms.
- Success of PPP projects is contingent upon meeting of obligations by stakeholder(s) in a timely manner as well as implementation of projects over reasonable timelines.
- However economic slowdown, lower-than-expected demand for services and a sharp rise in input costs -some of the issues that may impede smooth implementation of PPP projects.
PPP Projects-Implementation Issues

- A model that depends on private capital may be difficult to implement if the companies executing infrastructure projects are financially stressed and not in a position to raise more funds in the absence of radical restructuring.

- Further, the execution, operation, and maintenance capacities of implementing agencies also need to be properly assessed and appraised.

- The role of banks and financial institutions also needs a relook from the due diligence, appraisal and funding capacity perspective.
Infrastructure Financing

- In case of India, total investment in the infrastructure sector during the 12th FYP, estimated at approximately US$1 trillion is nearly double the investment made during the Eleventh FYP.

- The share of private investment in the infrastructure sector increased from 22 per cent in the Tenth FYP to 38 per cent in the Eleventh FYP and is expected to be about 48 per cent during the Twelfth FYP.

- Yet, more than half of the resources required for infrastructure- to come from the public sector, from the government, and the parastatals.
Infrastructure Financing

- Infrastructure development has always been a top priority for the policy planners;
- In India, keeping in view the current global scenario and the target for domestic growth rate, the development of this sector being seen as a trigger point for reviving the momentum in the economy.

- Several important steps to promote the flow of long-term funds in infrastructure sector like
  - liberalising the External Commercial Borrowings (ECB) regime to facilitate off shore fund flows to infrastructure.
  - raising the Foreign Institutional Investors (FII) limits for G-Sec & Corporate bonds
  - development of Corporate Bond Market;
  - setting up of the Infrastructure Debt Fund (IDF);
Funding of Infra Projects-IDF

- Recognising this constraint of incremental financing, banks have been permitted take-out financing through the Infrastructure Debt Funds (IDF) route.
- IDFs have been put in place to channelise long-term debt from other sources, including the domestic and foreign pension and insurance funds.
- Through innovative means of credit enhancement, policy interventions and tax incentives, it is expected to provide long-term low-cost debt for infrastructure projects by tapping into source of savings like insurance and pension funds.
Funding of Infra Projects-IDF

- However, from a Banker perspective, the trade-off between a good credit-risk projects vis-à-vis a greenfield projects with a much higher risk may not a good financial decision.

- In other words- the model does not envisage equitable distribution of risks and benefits.

- Banks assume credit and liquidity risk since the inception of the project but once the project is economically viable, taking out of the loan results in loss of opportunity of earning returns on seasoned loans.

- Further, if the original lenders/bankers are required to part with their security interest fully, their residual exposure would be sub-ordinated to the interest of the take out financier.
What is the Possible Way Out

- Need for some ‘out of box’ ideas;
- Of the various infra projects, those urgently needed in are power, roads, ports and airport sectors.
- Amongst these projects, power (other than solar) is perhaps the only project that could be termed ‘bankable’ i.e. it could repay principal and interest over a reasonable period of 7 to 10 years.
- All other have a very long life of over 20 years and, therefore, yield lower returns. These projects could barely pay interest on debt over the years and repayment of principal would pose an unreasonable burden on their cash flow even after 20 years or so.
Need for innovative financial products

- One possible solution: could possibly innovate a funding plan for ensuring that the principal is repaid without any problem after about 21 years.
- Under this scheme, the infra project’s cost would include an additional cost of around 17 per cent of cost.
- This extra amount could then be invested in a zero coupon sovereign debt with a maturity period of say, 21 years.
Need for innovative financial products

- To explain, let us assume the following cost and finance structure.
- The cost is Rs. 100 crore. Financing plan includes a debt of Rs. 70 crore and equity of Rs. 30 crore.
- Make a provision for another Rs. 17 crore. Then, the financial plan would involve a debt of Rs. 82 crore and equity of Rs. 35 crore.
- Invest Rs. 17 crore in a zero coupon GOI bond with a maturity of 21 years and embedded interest of 8 per cent. The bond would fetch around Rs. 82 crore on maturing, enough to meet the debt burden.
Need for innovative financial products

- The project would then have to service only the interest amount on the debt of Rs. 81 crore during the 21 years.
- Even this interest could be somewhat back-ended by charging a lower rate in the first few years and increasing it in the later years.
- Although, the Central Bank may have some reservation on such ‘teaser rates’, but it could make an exception in infra projects with long gestation periods.
Need for innovative financial products

- The Government could also extend some concessions such as exempting the zero coupon bond from income tax, both during the life of the bond and on maturity, only in respect of infra projects.
- And, of course, it should float such bonds for purchase by these projects. To ensure against misuse, these bonds should not be pre-payable before maturing under any circumstances.
- No doubt, this illustration is only a bare-bone structure and needs to be further fine-tuned.
Need for innovative financial products

- Also, if the present norm of 70:30 funding could be relaxed for infra projects to 3:1 (75-25) or even 4:1, the equity component for these projects would be more readily forthcoming.
- Another meaningful reform could be the manner of sharing the risk in financing.
- Under currently available models, banks are asked to provide initial funding and an infra financing company is prepared to ‘take out’ the loan after certain years.
Need for innovative financial products

- The initial period is the high-risk zone in long gestation infra projects. Either the infra financing company should provide funds in the initial period or at least take over the risk by guaranteeing banks in the first five years.

- Once the project starts yielding revenue, funding could be taken over by pension and insurance funds as they could provide long-term funds for them as principal would not be at any risk at all, with sovereign bond backing.
Thank You