India tries to free up banks for PPP lending

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Indias new Land Acquisition Act should remove some obstacles to developing infrastructure in the country. But domestic banks are reaching their exposure limits to project debt and international banks remain leery of what they see as a risky market. Indias troubled PPP sector is still in need of some fixes.

Much of Indias recent attention has been on roads and power generation, though long lists of airports, ports and water and sanitation facilities are waiting. But contractors limited bid capacity, land acquisition issues, and a lack of debt and equity have slowed development. Banks are fast approaching exposure limits to key infrastructure companies.

The experience so far for both developers and lenders had not been so good. For the roads sector, most projects have failed with land acquisition problems, environmental issues, cost overruns and delays to implementation making them unviable and unattractive, says Mukesh Kumar, vice-president in SBI Capitals infrastructure group.

Land acquisition looks up

The government late last year said it would fast-track approval for a collection of infrastructure projects worth $28 billion, hoping it would help cure macroeconomic ills. The rupee has been in a long decline against the dollar and Indias weak economic growth slowed its recovery from the global financial crisis.

The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 came into effect on 1 January, and will allow central and state government to guide land acquisitions, bringing in stricter rules and increasing landowners compensation significantly. Until now it has taken about 295 days to acquire or lease public land in India, more than twice the global average, according to World Bank data. Getting private land takes 99 days, versus a global average of 61 days.

The Navi Mumbai International Airport (NMIA) is the best example of the problems land acquisition can cause. The 1,160-hectare project is still 247 hectares short, as government negotiates with the residents of five villages who have been holding out for a better compensation package. The project missed construction deadlines by several years due to delays to environmental clearances, which finally arrived in 2010, and land acquisition problems. However, the City and Industrial Development Corporation of Maharashtra (CIDCO) finally launched tender for the Rs95 billion project in February

Banks say they expect the new law to make land purchases more costly and increase the time required to buy land. However, it also makes the entire process more transparent, as the new act requires developers to win the consent of 80% of affected land owners and 70% of the landowners for PPPs, reducing opportunities for litigation once a project is underway. The act also requires a compulsory social impact study before an acquisition can take place.

With the new act, in rural areas, people are to be paid four times the market price, and in urban areas it is to be twice the market price, which reduces the scope for land litigation, says Vivek Rao, a senior finance specialist in the Asian Development Banks South Asia department.

Against a backdrop of massive urbanisation, compensating farmers for their land helps ensure more inclusive growth and pushes India towards international environmental and social standards, says Isabel Chatterton, a manager at the International Finance Corporation, pointing to energy efficiency and water and sanitation as areas of need. Private investors know that these areas need attention, but it is also not clear to them if there is a supply of commercially viable projects or whether the municipal finances are strong enough to carry the projects.

The IFC launched a $1 billion offshore rupee bond in October 2013, in an attempt to help India internationalise the currency. The IFC will use the proceeds to finance private sector investment and provide another method of funding Indian corporates.

And India is starting to bring new PPP assets to market. In 2013 Punj Lloyd Infrastructure won and financed a bid to develop a residential complex for Delhi Police personnel. The Ministry of Home Affairs was the grantor for the concession, the first government housing PPP in India. SBI Capital was the lead arranger for its $178 million debt package.

Road dead ends, but airports take off

Indian project finance is still largely the province of domestic banks and sponsors, but international players say they are waiting for this to change. They say they see cracks appearing in the domestic model, which is not in line with international best practice.

Revenue forecasts continue to be a concern, and international banks are more conservative than the local banks on new traffic risk. Theyve had relatively negative experiences with that in Australia, Europe and Latin America, so when some of the Indian roads being financed had rather aggressive traffic forecasts the local banks were more comfortable with that than the international banks, says James Cameron, a managing director in HSBCs project finance group in Singapore.

In the 2012-13 fiscal year the National Highway Authority set a target of awarding bids for more than 8,000 km of roads, but only awarded 1,100 km. Developers bid aggressively for early projects, using optimistic revenue studies to justify paying hefty fees to government for the right to operate toll roads.

In January, a finance ministry committee finalised the restructuring of the premiums that developers owe the NHAI. The NHAI will offer relief to project companies, though they will not be able to pay dividends to their sponsors until they clear their arrears. The restructuring affects 39 road developers, including GVK, GMR Group and L&T IDPL

In a second piece of good news, the Reserve Bank of India (RBI) last year advised banks to view toll revenues as tangible assets, which allowed them to reclassify loans to the road sector as secured. Loans had been classified as unsecured because government retained nominal ownership of PPP assets, and attracted high interest rates.

And there has been some movement. SBI Macquarie Infrastructure Trust in November bought 74% of the Trichy Tollway from IJM of Malaysia and Shapoorji Pallonji, for Rs27.5 billion. The new road has been losing money but does not feature completion risk. That was SBI Macquaries third road purchase in the past year, after it bought 35% Ashoka Buildcons road assets for Rs8 billion and 74% of GMRs Jadcherla Expressways for Rs 20.3 billion.

Indian airports have attracted more than $9 billion in investment since 2005, and should attract the same amount during the current five-year plan, with the government pushing upgrades and new airports for the countrys smaller cities and towns, in order to increase regional connectivity and help relieve congestion at Indias major airports.

The pipeline of transactions with the risk profile and sponsor credit profile that would attract international banks has not been significant in the past 12 months, which is reflective of the slowdown in the capex cycle seen all over India during the same period, Mr Cameron said.

Non-bank novelties

So far debt financing for Indian infrastructure has come primarily from banks, but the local banking sector is close to its exposure limits for infrastructure debt, the volume of which has been increasing at a compound annual growth rate of

40% over the past decade. Banks also have to cope with heavy exposures to a small number of developer names with multiple projects.

One of the key reasons for the slowdown in activity is the exhaustion of bid capacity at the big developers. We think it would help to have some of the big players merge, to have more and larger players, says Rao, pointing out that the developers tend to be the same, regardless the sector, with GVK, GMR and L&T playing large roles.

The ADB in October approved a $700 million loan to India Infrastructure Finance Company (IIFCL), part of a multitranche financing facility. The proceeds will fund direct loans potentially including subordinated loans to project developers and refinance bank loans, freeing up banks to invest in other greenfield projects and ease their sector and borrower exposure limits. The $400 million first tranche was signed in February 2014.

Banks have been funding loans to projects with short-term deposits, creating a significant liability mismatch. When roads suffer delays to completion or slow ramp up periods it hinders banks ability make new loans. We are interested in having a vigorous take-out market, and were starting on that with the infrastructure debt funds, said Sharmila Chavaly, joint secretary for infrastructure at Indias Ministry of Finance.

Infrastructure debt funds (IDFs) should allow institutional investors such as insurance and pension funds to gain exposure to infrastructure assets. Two funds India Infradebt (ICICI Bank, Bank of Baroda, Citi and Life Insurance Corporation of India) and IL&FS Infra Debt Fund (a joint venture between IL&FS and eight public sector banks) are raising commitments.

A secondary equity market might develop alongside a secondary debt market in India, rather than preceding it, as has happened elsewhere in PPP. The Securities and Exchange Board of India (Sebi) gave clearance for infrastructure investment trusts (InvITs), in December.

The trust model draws on the experience of Singapore and Hong Kong, and the growth of master limited partnerships in the US. The sponsor of an InvIT must be an infrastructure developer or a special purpose vehicle (SPV), and each InvIT will need to have a mix of pre-completed projects and projects generating cash flows.

But the real way to attract more international investors, and particularly institutional investors, will be to develop Indias bond market. We are very interested in corporate bond development for infrastructure funding, and in particular in seeing a secondary market take off, and wed also like to see a municipal bond market take off, says the Finance Ministrys Chavaly.

The ADB, together with IIFCL, in 2012 introduced a $128 million (Rs7.168 billion) guarantee facility that they hoped would foster an Indian infrastructure bond market. It provides partial guarantees on rupee-denominated bonds issued by infrastructure projects, and places some of that risk with the ADB. The partial guarantees should boost the credit rating of a typical infrastructure project from BBB- or A to AA, the level at which pension funds, insurers and other institutional investors are comfortable.

The problem with the bond market is that yields are going up and up and project developers see that it is not in their interest to issue bonds right now, especially if they dont want to fix rates at this point in the cycle. Once the market is a bit more benign we think there will be significant appetite for this product, says the ADBs Rao.

India's infrastructure pipeline

Project name	Sectors	Country	Status	Status date	Concession awarder	Project Amount
Kushinagar Airport	Transport > Airport	Asia > India	RFQ	08/01/2013	State Government of Uttar Pradesh	
NH-23	Transport > Highway maintenance	Asia > India	Shortlist	06/02/2013	National Highways Authority of India (NHAI)	$m54

Maharashtra Border Road Project	Transport > Highway maintenance	Asia > India	Preferred bidder	08/02/2013	Madhya Pradesh Road Development Corporation	$m18
NH-10	Transport > Highway maintenance	Asia > India	RFP	11/02/2013	National Highways Authority of India (NHAI)	$m244
Kerala Airport	Transport > Airport	Asia > India	Feasibility	18/03/2013	Kerala State Industrial Development Corporation	
Mopa Airport	Transport > Airport	Asia > India	Feasibility	01/04/2013	Goa Government	$m470
NH-12 Toll Road	Transport > Highway maintenance	Asia > India	Tender launched	03/04/2013	National Highways Authority of India (NHAI)	
Cambridge Biomedical Campus Development	Social Infrastructure/PPP/P3/PFI > Healthcare	Asia > India	Preferred bidder	29/04/2013	Cambridge University Hospitals	$m186.98
Zozila Tunnel PPP Project	Transport > Tunnel	Asia > India	RFQ	05/06/2013	The Border Roads Organisation (India)	
Haryana-Gujarat Rail Track	Transport > High-speed rail	Asia > India	Preferred bidder	14/06/2013	Indian Ministry of Railways	$m1140
Kolkata Port	Transport > Port	Asia > India	Shortlist	22/07/2013	Kolkata Port Trust	$m251
Tuna-Tekra Container Terminal	Transport > Port	Asia > India	RFQ	13/08/2013	Kandla Port Trust	$m421
Sambalpur Waste Project	Social Infrastructure/PPP/P3/PFI > Waste	Asia > India	RFQ	14/08/2013	Sambalpur Municipal Council	
Lucknow Airport	Transport > Airport	Asia > India	Tender launched	10/09/2013	The Indian Ministry of Civil Aviation	$m78
Chennai Airport	Transport > Airport	Asia > India	RFQ	11/09/2013	The Indian Ministry of Civil Aviation	$m187
Sambalpur-Rourkela Highway Project	Transport > Real toll	Asia > India	Preferred bidder	13/09/2013	The Government of Odesha	$m202
Guwahati Airport	Transport > Airport	Asia > India	RFQ	08/10/2013	The Indian Ministry of Civil Aviation	$m97.02
Jaipur Airport	Transport > Airport	Asia > India	RFQ	08/10/2013	The Indian Ministry of Civil Aviation	$m88.94
Kolkata Airport	Transport > Airport	Asia > India	RFQ	08/10/2013	The Indian Ministry of Civil Aviation	$m113
Ahmedabad Airport	Transport > Airport	Asia > India	RFQ	08/10/2013	The Indian Ministry of Civil Aviation	$m113
Ennore Port Expansion Project	Transport > Port	Asia > India	Prequal bids in	10/10/2013	Ennore Port	
Sambalpur-Rourkela	Transport > Real toll	Asia > India	Preferred bidder	15/11/2013	Odisha Works Department	$m204
Navi Mumbai International Airport PPP	Transport > Airport	Asia > India	RFQ	11/02/2014	CIDCO	$m1500
Jawaharlal Nehru Port Container Handling Facility	Transport > Port	Asia > India	Preferred bidder	28/02/2014		$m100

Source: Project Finance Deals Database