Power Price Renegotiation May Put Rs 1.5 Lakh Crore In Bank Loans At Risk

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Nearly Rs 1.5 lakh crore in bank loans to power producers in India could be at risk if more states decide to renegotiate power purchase agreements (PPAs), two bankers in the know told BloombergQuint. Three states – Uttar Pradesh, Karnataka and Andhra Pradesh – have either cancelled purchase agreements or are reworking them, the bankers confirmed.

The fear surrounding loans to power producers comes at a time when the Indian banking sector has seen stressed assets rise to over Rs 10 lakh crore. The hope was that stressed assets will peak close to these levels. However, bankers now fear that the power sector could emerge as a new pressure point in the quarters ahead.

There is a significant amount of money that has been loaned for new power plants, said the first of the two bankers quoted above. He added that banks have so far been dealing with stress in loans to older power plants and if incremental stress emerges from loans to newer power generation projects, it could be 'too much to handle.'

The trouble stems from a steep drop in spot power prices, which has left states feeling that they are paying too much under the existing power purchase agreements. As such, state-owned distribution companies, which are also under an obligation to reduce losses as part of the UDAY scheme, are keen to buy cheaper power to that part of the Rs 4.3 lakh crore in debt was taken over by the respective state governments. Along with that restructuring, DISCOMS were asked to improve operational efficiency through various means such as smart metering, etc.

> The target given to these DISCOMs was to eliminate the gap between average revenue realised (ARR) and the average cost of supply (ACS) by 2018-19.

The two bankers quoted above said that this target is a key reason that states are keen to renegotiate or cancel PPAs. Should they be able to reduce the cost of power purchase, these states would be in a better position to bring down their losses.

So far, three states have moved in that direction but the fear is that other states could also be tempted to renegotiate purchase agreements given the prevailing low price of spot power, said the second banker quoted above who is a senior official at the Indian Banks Association (IBA).

The IBA has sought intervention from the central government in the matter to avoid a further build-up of bad loans, the Economic Times reported on Monday.

The Power Pricing Arbitrage

According to Kotak Securities analyst Murtuza Arsiwalla, the price of power at spot exchanges is currently at about Rs 2.5 per kWh (Kilo Watt hour). This is much lower than the average rate of Rs 4 per kWh agreed upon as part of the long-term PPAs signed with new power plants.

Sudhir Kumar, analyst at CARE Ratings Ltd., told BloombergQuint that a large part of the drop in power prices is attributable to the oversupply in the market. "There has been significant addition in renewable power capacity and we are seeing thermal power plants running at low plant load factors," Kumar said. He, however, warned that situation could reverse quickly should power demand, particularly from industry, pick up.

> *Once India starts growing faster, the demand for industrial power will go up and that will push up merchant power rates.*
>
> **Sudhir Kumar, Analyst, CARE Ratings**

According to the head of corporate lending at a large private sector bank, the arbitrage between spot power and long-term PPAs may prove to be a short-term advantage. Eventually, states will have to reconsider their dependence on the spot market as it will not be able to cater to all their needs, he said.

The first banker quoted above agreed that the arbitrage is a problem. Maybe, this practice of PPAs needs to be relooked at and all power should be bought through the merchant power market, he said. This, however, could become untenable due to the volatility in merchant power prices which would hit both power producers and power purchasers.

The Bank Exposure Math

Around 65,000 MW of thermal power generation capacity was under construction in India, to come up by 2022, according to an October 2016 report by Greenpeace.

According to analysts, the average cost of setting up 1 MW of power producing capacity works out to roughly Rs 6 crore. About 75 percent of this cost is funded through debt. Back-of-the-envelope calculations suggest that roughly Rs 2.9 lakh crore in bank loans are tied to this power capacity.

Of this, roughly half (or close to Rs 1.5 lakh crore) is to companies which have PPAs in place with state governments which could come up for renegotiation, said the first of the three bankers quoted above. The second banker confirmed that the amount of loans potentially at risk could be in that range.

Bankers flagged off the risk emerging from loans to power producers following the release of their first quarter earnings. Private sector lender Axis Bank, in an analyst conference call on July 25, said that most of its 'watch list' for stressed assets is now centered around the power sector. ICICI Bank, too, has identified power as among the list of sectors from where stress could continue to emerge.

Total loans to the power sector, including those to distribution and transmission firms, stands at Rs 5.2 lakh crore, shows the RBI's sectoral lending data.

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