Changes in HAM concession - A credit positive

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In a bid to address the key issues faced by the stakeholders under existing concession agreement and to enhance the bidding appetite for Hybrid Annuity Model (HAM) based road projects, Ministry of Road Transport and Highways (MoRTH), on Nov 10, 2020, issued revised model concession agreement for new HAM-based road projects.

Key changes introduced in the revised model concession agreement of HAM are:

1. Interest annuities for upcoming HAM projects are now linked to average of one year MCLR of top five scheduled commercial banks as against bank rate linked interest annuities payable under existing agreement.
2. Release of construction annuity in ten tranches as against five tranches of existing concession agreement.
3. Increase in effective interest rate on mobilization advances from authority.
4. Allowing 100% change of ownership post six months from commercial operations date (COD) as against current lock in a period of two years from COD.

Linking both borrowing rate and interest annuities to common benchmark is expected to lend greater stability to cash flows in the operational phase while offsetting the risk of non-linear transmission of bank rate over lending rate. *Ceteris Paribus*, CARE Ratings expects improvement in the average DSCR by about six percent and project internal rate of return (IRR) by 110 bps under revised model concession agreement. CARE Ratings estimates improvement in the working capital cycle by around fifteen days for the road developers executing HAM projects due to phasing out of construction annuity under revised agreement. Nevertheless, utilization of fund-based working capital limits is expected to increase largely due to the absence of interest rate arbitrage between mobilization advances and working capital limits for strong developers.

This article brings out the key credit implications of above measures on HAM special purpose vehicles (SPVs) and developers executing HAM projects as tabulated below. All rates mentioned are as of November 18, 2020.

Key changes in the revised model concession agreement are tabulated below:

Terms of existing concession agreement	Terms of revised model concession agreement	CARE Ratings' view
Interest annuity in the operational phase is linked with bank rate (i.e., 4.25% per annum currently).	Interest annuity in the operational phase to be linked with average of one-year MCLR of top five schedule commercial banks (i.e.,7.32% currently) based on their balance sheet size, on September 1st of every financial year.	⇧ Both borrowing rate and interest annuities are linked to common benchmark. This is expected to lend greater stability to cash flows in the operational phase while offsetting the risk of non-linear transmission of bank rate over lending rate.
Interest annuity is payable in the operational phase on reducing balance of completion cost at bank rate plus 300 bps (i.e. 7.25% per annum currently).	Interest annuity is payable in the operational phase on reducing balance of completion cost at average of one-year MCLR of top five schedule commercial banks plus 125 bps (i.e., 8.57% per annum currently).	⇧ Based on estimates of CARE Ratings, there is a negative carry of around 100 bps between borrowing rate and interest annuity rate in the ongoing HAM projects due to non-linear transmission of bank rate over lending rates. Risk of negative carry on interest annuity is entirely eliminated under revised clauses of concession agreement. ⇧ *Ceteris Paribus*, CARE Ratings expects improvement in the average DSCR by 6% and project IRR by 110 bps under revised model concession agreement as compared to the ongoing HAM projects linked to bank rates.
100% transfer of equity stake is permitted only after two years of commercial operation date (COD).	100% transfer of equity stake is permitted after six months from COD.	⇧ Positive impact for the stake sale and InvIT transactions for upcoming HAM projects.

Terms of existing concession agreement	Terms of revised model concession agreement	CARE Ratings' view
Construction annuity is payable in five equal installments of 8% each.	Construction annuity is payable in ten equal installments of 4% each.	⇧ Increase in the tranches of construction annuity is expected to improve the cashflow during construction period while deferring the term debt disbursement. CARE Ratings estimates improvement in the working capital cycle by around fifteen days for the road developers executing HAM projects due to phasing out of construction annuity under revised concession agreement.
Mobilization advances can be availed from authority at bank rate.	Mobilization advances can be availed from authority at 1 year average MCLR of top five scheduled banks +125 bps.	⇩ Interest cost of developers is expected to rise to an extent as a result of increase in effective rate of interest on mobilization advances from 4.25% per annum currently to 8.57% per annum under revised concession agreement. Furthermore, utilization of fund-based working capital limits are also expected to increase largely due to partial shift from mobilization advances to working capital borrowings to reduce the cost of borrowing.
Developers have flexibility to decide cost of the project for financial closure.	Cost of the project should not be less than 90% of NHAI cost for the purpose of financial closure.	⬄ Neutral from credit perspective for the project awarded to strong sponsor as there is a fixed-price Engineering Procurement and Construction (EPC) contract with such sponsor.

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