Impact Analysis of Draft RBI Guidelines on Under-Construction Infra Projects

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Synopsis

In this report, CareEdge Ratings discusses the potential impact on financing under-construction infrastructure projects following the implementation of the draft guidelines issued by the Reserve Bank of India (RBI) on May 3, 2024.

The key impacts of implementing the draft guidelines are hereunder:

- The sharp increase in provision for standard assets to 5% for all fresh and existing project loans in under construction will have a direct impact on the cost of debt. Consequently, this will dampen the bidding appetite from infrastructure developers in the medium term.
- A mandatory tail period of 15% of the project's economic life is estimated to reduce the leverage carrying capacity by 8-10% from the current level especially for the projects having shorter concession, while it is estimated to increase equity requirements by 8-10% for realigning loan tenor to 85% of economic life. It also restricts top-up loan-raising abilities of all types of infrastructure projects.
- Projects with cost overrun (due to a change of scope) of less than 25% will face asset classification-related challenges and an increased financial burden on the project sponsor.
- Shifting the condition of minimum unencumbered land availability from the existing pre-disbursement condition to a pre-sanction stage will lead to an unwarranted delay in achieving financial closure.
- Restricting the permissible timeline for cumulative deferment of DCCO (infrastructure projects) to 3 years from the earlier limit of 4 years including reasons for litigation is viewed as stringent. Since the litigation cases require longer time to resolve, this modification may result in the re-classification of such exposures (at the lender's end) and a consequent step-up in borrowing costs during the implementation phase.
- The debt raised at the InVIT level appears to be kept out of the ambit of this RBI circular, and therefore there is an increased likelihood of operational assets to be transferred to InvIT and raising debt at the InvIT level.

Particulars	Draft guidelines of RBI	Impact Analysis
Credit Event	A credit event shall be deemed to have occurred if there is a default; and/or lenders determine a need for an extension of the originally envisaged Date of Commencement of Commercial Operations (DCCO) of the project or any subsequent extension of already amended DCCO; and/or lenders determine a need for infusion of additional debt; and/or if there is a diminution in the net present value (NPV) of the project. Upon trigger of any of these events, lenders are required to I. Review the account within 30 days of the occurrence of the event.	Upon implementation of the draft guidelines, the defined credit event will be addressed through a resolution plan for projects in under construction phase. Further, the resolution plan is to be implemented in a time-bound manner. This will increase monitoring requirements for lenders and other stakeholders.

	II. Implement the resolution plan within 180 days from the end of the review period.	
Land availability	For infrastructure projects under the Public-Private Partnership (PPP) model, unencumbered land availability to the extent of 50% or more, environment clearance etc can be considered by lenders to achieve financial closure.	In the existing concession agreements for road projects implemented under the Public-Private Partnership (PPP) model, the declaration of the appointed date to commence construction is contingent upon the Authority providing at least 80% of the land to the developer. This safeguards the risk related to land availability. Generally, the land availability and required clearances for the developer to commence construction is a pre-disbursement condition for loan disbursement of under construction projects. However, shifting this condition to a pre-sanction stage could result in unwarranted delays in achieving financial closure.
Moratorium on repayments	The moratorium period shall not exceed six months from the commencement of commercial operations	Greenfield infrastructure projects facing demand risk require a longer gestation period. Consequently, a six-month moratorium may not be sufficient for projects with higher demand risk. In the case of availability-based projects such as annuity road projects, the first annuity is due and payable within 15 days of the 180th day of achieving DCCO as per terms of concession and thereafter annuity is received in every subsequent 6 months. If the repayment is structured with a moratorium of six months from DCCO and the principal is paid every subsequent 6 months, reliance on sponsor support increases until the built-up of full DSRA. The temporary cash flow mismatch potentially arises from the nonavailability of an adequate gap between the annuity due date and repayment obligation date to address the delay in annuity receipts.
Loan tenor	The original or revised repayment tenor, including the moratorium period, if any, shall not exceed 85% of the economic life of the project.	Typically, infrastructure projects such as airports, seaports, thermal plants, renewable projects, electricity transmission, and gas pipelines have longer economic life and concession periods. Hence, the proposed condition on loan tenor including a moratorium not exceeding 85% of the asset's economic life will not have any material adverse impact at the time of financing of these projects. However, in the case of projects having shorter concessions, such as road annuity projects where the operational period is 15 years, the said tenor condition will leave the projects with a tail period of 2.25 years compared to the existing 1 to 1.5 years. While this reduces the overall repayment period by a year, it also decreases the leverage-carrying capacity by 10% from the current level,

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<tr><td></td><td></td><td>while maintaining the same debt service coverage ratio (DSCR). Additionally, a mandatory tail period of 15% of the economic life of the project restricts the top-up loan-raising abilities of all types of infrastructure projects in the operational phase for meeting exigencies and unlocking equity infused by the sponsor.

CareEdge Ratings estimates an increase in equity requirement by 8-10% for Hybrid Annuity Model (HAM) projects for realigning project loan tenor to 85% of economic life.</td></tr>
<tr><td>Financial Parameters post implementation of RP</td><td>Post implementation of the resolution plan (RP), financial parameters like D/E ratio, DSCR etc, and external rating if any, shall remain unchanged or enhanced.</td><td>No significant impact.</td></tr>
<tr><td>Allowable deferment of DCCO while retaining standard asset classification</td><td>Permissible deferment of DCCO from the DCCO originally envisaged in the financing agreement, while retaining the ‘standard’ asset class for:
Exogenous Risks: Up to 1 year including Commercial Real Estate Projects (CRE).
Endogenous Risks: Up to 2 years for infrastructure projects. Up to 1 year for Non-infrastructure projects (excluding CRE projects)

Litigation (Court Cases): Up to 1 year (including CRE projects).

Cumulative deferment of DCCO shall not exceed 3 years for infrastructure projects and 2 years for non-infrastructure projects (including CRE projects).</td><td>Earlier, in the case of infrastructure projects, the deferment of DCCO including litigation was permissible for up to 4 years, while for reasons beyond the control of the company/sponsor stood at 3 years. However, the current permissible deferment of DCCO has been restricted to 3 years.

Given that litigation cases require a longer time to resolve, this modification may result in the re-classification of such exposures (at the lender’s end) and a consequent step-up in borrowing costs during the implementation phase.

However, there is no change in the permissible timeline for deferment of DCCO for non-infrastructure projects including CRE and thus no impact on them.</td></tr>
<tr><td>Provisioning of under construction accounts in the standard category.</td><td>A general provision of 5% of the funded outstanding shall be maintained on all existing as well as fresh under construction exposures on a portfolio basis.

For accounts, that have availed DCCO deferment and the cumulative deferment exceeds 2 years for infrastructure projects and 1 year for non-infrastructure projects, an additional 2.5% provision is to be maintained.</td><td><table>
<tr><th>Particulars</th><th>Earlier Prov. Requirement</th><th>Revised Prov. Requirement</th></tr>
<tr><td>DCCO up to 2 years for infra or 1 year for non infra</td><td>0.4%</td><td>5%</td></tr>
<tr><td>DCCO exceeding 2 years for infra and 1 year for non-infra</td><td>5% from the date of restructuring or 2 years from the date of restructuring, whichever is later</td><td>Additional 2.5%, which is reversed upon achieving commercial operations.</td></tr>
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The change in provisioning standards will have a direct impact on the cost of debt. Consequently,</td></tr>
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		this may dampen the bidding appetite from infrastructure developers in the medium term. For example, in availability-based projects such as annuity, for every increase of 100 bps in interest rate, there will be a drop of 5-7 bps in the average DSCR profile. In the case of demand-based projects such as toll etc, for every increase of 100 bps, the decline in average DSCR may be of 7-10 bps.
Provisioning for operational projects	Upon achieving the operational phase, the provision can be reduced from 5% to 2.5% of the outstanding exposure. Further, the same can be reduced to 1% upon the project achieving a) a positive net operating cash flow that is sufficient to cover current repayment obligation to all lenders, and (b) the total long-term debt of the project with the lenders has declined by at least 20% from the outstanding at the time of achieving DCCO.	Road annuity or transmission or commercial real estate projects or projects with assured offtake arrangement have greater stability to cash flows. These projects on average take 3 to 3.5 years to repay 20% of the outstanding debt from the cash flows upon achieving commercial operations. However, the projects become self-reliant within 1 year upon establishing a payment track record from the counterparty, thereby resulting in significant improvement in the credit risk profile. Therefore, the requirement to reduce debt by 20% for the reduction in provisioning purposes may result in delayed realisation of benefits despite an enhanced credit profile. However, a mandatory debt reduction requirement of 20% for lower provisioning is a welcome move for demand-based projects to avoid bulky back-ended repayments in the later part of the concession. Intuitively, it appears that the debt raised at the InVIT level is out of the ambit of this circular.
Change in repayment schedule of project loan due to increase in project outlay for reasons other than cost overrun	The benefit of a standard category account is permitted in case i) an increase in scope of the project takes place before DCCO ii) a rise in project cost excluding cost overrun in respect of the original project is 25% or more of the original outlay iii) lenders re-assess the viability of the project before approving the enhancement of scope and iv) on re-rating (if already rated) new rating is not below the previous rating by more than one notch. If project debt is unrated then it should be rated investment grade upon such increase in scope. Lenders may fund cost overrun a maximum of 10% of the original project cost. The risk premium charged on the additional funding will be a minimum of 1.00%.	Under infrastructure projects, an increase in the scope of the project is generally reimbursed by the authority separately or added to the regulatory asset base in airports and the power sector. However, the significant increase in the scope of the project and the consequent requirement to change the repayment schedule is a concern area for projects without concession. For projects with cost overrun (due to change of scope) less than 25% will face asset classification-related challenges and increased financial burden on the project sponsor. Even for projects facing cost overruns beyond 25%, the incremental debt for change in scope is restricted to 10% of the original cost with an additional risk premium of a minimum of 1%. (For example, Rs 2000 crore project, the change in scope of Rs 500 crore shall be funded with a maximum additional debt of Rs 200 crore).

CareEdge Ratings' View

"The draft guidelines for project financing proposed by the RBI, if implemented, are expected to present funding challenges for both under-construction and operational infrastructure projects. A mandatory tail period accounting for 15% of a project's economic life will restrict the ability of infrastructure projects to secure additional top-up loans. CareEdge Ratings estimates that this will necessitate an 8-10% increase in equity requirements for HAM-based road projects to align the loan tenure with 85% of the economic life for concessions lasting 15 years," said Rajashree Murkute, Senior Director at CareEdge Ratings.

"Projects with stable cash flows, such as road annuities, transmission, and commercial real estate, typically see an improvement in credit profile within one year of establishing a payment track record from the counterparty. Therefore, the mandate to reduce debt by 20% to lower provisioning could delay the realisation of interest rate benefits for such operational projects, despite an enhanced credit profile. Nonetheless, a compulsory 20% debt reduction to achieve lower provisioning is considered a positive step for demand-based projects, as it mitigates the risks associated with bulky back-ended repayments and subsequent refinancing."

Further elaborating on other changes, Murkute adds that defining a specific credit event and implementing a resolution plan in a time-bound manner will necessitate increased monitoring and timely reviews from all stakeholders. Infrastructure projects, being capital intensive, are highly sensitive to changes in interest rates. Consequently, a significant rise in the provisioning requirement from 0.4% to 5% during the construction phase is likely to diminish the bidding appetite of developers in the medium term.

For instance, in availability-based projects such as annuities, each 100-basis point increase in interest rate is likely to result in a 5-7 basis points reduction in the average Debt Service Coverage Ratio (DSCR) profile. In the case of demand-based projects, such as toll roads, each 100-basis point increase may lead to a decline of 7-10 basis points in the average DSCR.

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