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Infrastructure Financing - PPP

In recent years, efforts have been made by the Government of India (GoI) to step-up investment in infrastructure, and particularly to catalyze greater private investment. The Government of India's Economic Survey, 2017 – 2018, reports that there has been a substantial investment in infrastructure in India, particularly in the transportation, energy, communication, housing and sanitation and urban infrastructure sectors. The Global Infrastructure Outlook predicts that rising income levels and economic prosperity would drive demand for further infrastructure investment in India over the next 25 years. It is estimated that investments of about US$ 4.5 trillion would be required till 2040 to develop infrastructure to achieve economic growth targets. The current trend shows that India can meet around US$ 3.9 trillion infrastructure investment out of US$ 4.5 trillion. The cumulative figure for India's infrastructure investment gap would be around US$ 526 billion by 2040. The reasons behind the shortfall in investment were: the collapse of Public-Private Partnership (PPP) especially in power and telecom projects; stressed balance sheet of private companies; issues related to land and forest clearances.

There is a need to fill in the infrastructure investment gap by financing from private investment, institutions dedicated for infrastructure financing like National Infrastructure Investment Bank (NIIB) and also global institutions like Asian Infrastructure Investment Bank (AIIB) and New Development Bank which is focusing more on sustainable development projects and infrastructure projects.

The International Finance Corporation (IFC) of the World Bank Group has estimated investment opportunities in India is US$ 3.1 trillion from 2018 to 2030, based on its recent analysis of the climate-smart investment opportunities in infrastructure sectors like renewable energy, transportation, climate-smart water supply, solid waste management, green buildings, climate-smart agriculture and large hydro projects. A similar report by Asian Infrastructure Investment Bank (AIIB) on infrastructure finance released in 2019, states AIIB's priority is to mobilise private capital into infrastructure. It has a focused mandate on infrastructure project financing, and it does not offer concessionary funding. It says that AIIB will try to develop a high degree of flexibility in financing through various instruments. The failure of the PPP model to deliver on various aspects has to lead the Government to look to finance projects by improving their commercial viability.

The announcements made by the Government of India in Union Budget 2018-19 indicate the way forward in the coming future:

- A massive push to the infrastructure sector by allocating Rs 5.97 lakh crore (US$ 92.22 billion) for the sector.

- Railways received the highest ever budgetary allocation of Rs 1.48 trillion (US$ 22.86 billion).
- Rs 16,000 crore (US$2.47 billion) towards Sahaj Bijli Har Ghar Yojana (Saubhagya) scheme. The scheme aims to achieve universal household electrification in the country.
- Rs 4,200 crore (US$ 648.75 billion) to increase the capacity of Green Energy Corridor Project along with other wind and solar power projects.
- Allocation of Rs 10,000 crore (US$ 1.55 billion) to boost telecom infrastructure.
- A new committee to lay down standards for metro rail systems was approved in June 2018. As of August 2018, 22 metro rail projects are ongoing or are under construction.
- Rs 2.05 lakh crore (US$ 31.81 billion) will be invested in the smart cities mission. All 100 cities have been selected as of June 2018.
- India's national highway network is expected to cover 50,000 kilometres by 2019. National highway construction in India has increased by 20 per cent year-on-year in 2017-18.

The PPP model is being used increasingly as a mechanism to raise funds for infrastructure projects from financial markets, rather than tax revenues and loans from public development institutions. This is leading to the creation of revenue streams for the investors rather than infrastructure based on the needs and demands of the local communities or public welfare. Although there are problems with the PPP model for infrastructure development, they are being promoted by various government and international agencies to implement the mega infrastructure projects. The problems of financing and operationalising PPP contracts in roads, power, water supply, sanitation have been well documented not only in India but across many other countries. Regardless of these experiences and evidence, the PPP model is strongly recommended for more such projects. The World Bank Group Country Partnership Framework for India states that to leverage private finance, increasing focus on facilitating private sector solutions to development challenges including steps such as advisory and lending support for PPP transactions.

Key Constraints in Financing Infrastructure

Infrastructure projects are complex, capital intensive, long gestation projects that involve multiple and often unique risks to project financiers. Infrastructure projects are characterized by non-recourse or limited recourse financing, i.e., lenders can only be repaid from the revenues generated by the project. This limited recourse characteristic, and the scale and complexity of an infrastructure project makes financing a tough challenge, which is further compounded by two factors. First, a combination of high capital costs and low operating costs implies that initial financing costs are a very large proportion of the total costs. Second, infrastructure project financing calls for a complex and varied mix of financial and contractual arrangements amongst multiple parties including the project sponsors, commercial banks, domestic and international financial institutions (FIs), and government agencies.

Raising adequate equity finance is the most challenging aspect of infrastructure project financing, as equity providers take the highest level of operational, financial and market risk. Since the exit options for equity investors are limited and the risk levels are high, adequate equity investments are not

forthcoming. Other constraints are a shallow capital market and weaknesses in corporate governance. The reasons for this are (i) the lack of a sufficiently large and commercially viable pool of infrastructure projects, which leads to a preference among funding institutions to opt for straightforward loans and (ii) restrictions on external commercial borrowing (ECBs), etc.

Underdeveloped debt markets are yet another key constraint in infrastructure financing, given that most infrastructure projects begin to generate profits in 10-15 years and require longer term debt. The lack of size and depth in India's corporate bond market is associated partly with the lack of depth in the government bond market and the absence of a yield curve for government bonds which could serve as a benchmark for corporate bond. A fundamental factor limiting the participation of all types of FIs in infrastructure financing relates to regulatory uncertainty, which increases the risk-profile of infrastructure sectors, and makes FIs reluctant to finance infrastructure, particularly in the early stages, where project risks are concentrated. Restrictive Government policies and regulatory guidelines have further constrained the participation of insurance companies and pension funds in infrastructure. For example, Insurance Regulatory and Development Authority (IRDA) requires insurance companies to invest in debt paper with a minimum credit rating of 'AA', which automatically excludes investment by insurance companies in debt paper of most private infrastructure sponsors. Insufficient knowledge and appraisal skills related to infrastructure projects also pose a constraint.

An enabling fiscal environment is a prerequisite for attracting private sector players to inherently high risk ventures. There are some fiscal issues—particularly in relation to Sections 10(23G) and Section 80IA of the Income Tax Act—that need to be ironed out in order to give further fillip to infrastructure sectors. Also, the fact that nearly all states suffer from serious fiscal imbalances and are ridden with huge debt obligations does not make them the most bankable business partners for the private sector.

Regulatory Clearances - Infrastructure projects require multiple clearances at centre, state and local levels, resulting in serious delays. The time taken to obtain all the requisite approvals for an infrastructure project can vary between a low of 18 months to as much as four to five years. In spite of many states having introduced, on paper, 'single window clearance', the fact remains that when most projects apply for approvals at the state-level, these have to go through multiple clearances at various levels. ‹ Most infrastructure projects involve dealing with multiple ministries. One of the key reasons for projects not taking off at the prefinancing stage is that the actions and policies of different ministries are not coordinated and are often at variance with each other. ‹

Problems in contract negotiations and delays in the award of contracts are pervasive across all infrastructure sectors.

Streamlining Approvals, Cutting Down on Red Tape and Enhancing Infrastructure Regulation ‹- Governments need to assure potential investors that there is an intention to lay out clear policy frameworks for each sector and reduce uncertainties arising out of policy implementations and arbitrary actions in contractual commitments of the governments. ‹All infrastructure projects involve multiple clearances from different Ministries and Departments — which contribute to significant delays. In order to mitigate this problem, the Government of India needs to set up sufficiently high-level Inter-Ministerial groups for roads, power, telecom, ports and airports. In addition, each Ministry substantively dealing

with infrastructure should adopt the practice introduced by the Ministry of Power by setting up Inter-Institutional Groups (IIG).

Stimulating Public Private Partnerships — There is a need to encourage entry of the private sector in infrastructure development through viable PPP projects. The private investors in infrastructure look for stable and friendly sector-specific policies. Developing domestic capabilities to manage, participate in and finance private infrastructure projects is important to broaden the constituency of PPPs, enlarge the pool of funding, and mitigate foreign exchange risk. In industrialized countries, and increasingly in more mature reformed developing countries, one of the largest sources of financing for investment is the utility's own cash flow. But additional funding will have to come from domestic capital markets and from pension funds/ insurance companies. This will require a strong macroeconomic framework and a solid financial infrastructure, as well as attractive investment opportunities. To encourage PPPs, the Government of India has announced that it will provide viability gap financing for selected infrastructure projects which are socially and economically necessary but carry either high risk or inadequate Internal Rate of Return (IRR) to be fully funded by the private sector. According to the policy, up to 40 percent of the financing needs of such projects could be met through VGFs. This could help to hasten the financial closure of many infrastructure projects. For instance, the 22.5 km long Trans-Harbor Bridge that is proposed for Mumbai and costing over $1 billion is not feasible without at least 30 percent viability gap funding. However, the success of the viability gap funding policy will require, among other things, strengthening the institutional capacity of government to manage, participate in, and monitor PPPs.

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