Panel Discussion on

INNOVATIVE TOOLS FOR LONG TERM INFRASTRUCTURE FUNDING

Mrs. Arundhati Bhattacharya
MD & CEO

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Macro-Economic View

- GDP growth rate of 5.4% in the first half of 2012-13; overall growth for 2012-13 dropped from last year to 5%
- India needs to double its infrastructure spending to ~10% of its GDP to achieve 8-9%+ GDP growth which further requires new funding sources
- Investment target in infrastructure has been doubled from Rs. 27 lakh crores (eleventh plan) to Rs. 51 lakh crores during the twelfth Plan period (2012-17)
  - Å ~47% of investment expected to come from the private sector
- Major funding sources for infrastructure spending are budgetary support & debt funding
  - Å In the first 3 years of eleventh plan, budgetary support constituted ~45% of the total infrastructure spending
  - Å The debt from Commercial Banks (21%), NBFCs (10%), Insurance companies (4%) and the external sources (6%) constituted ~41% of the funding
  - Å Balance 14% of the was funded through equity and FDI

Key Challenges for Infrastructure Development (1/2)

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- Major issues are Land acquisition, environment clearances, delay in approvals etc.; one of the key one is the availability of adequate long term funds
- India's Sovereign credit rating of BBB- limits investment from foreign funds
- Lack of depth in the financing market
  - Limited ability of banks to engage short term funds for long-term investment leading to asset liability mismatch
  - ECB funding imposes all in cost ceiling that allows access only to highly rated companies
  - Almost one third of India's saving rate of 37% is directed towards physical assets instead of financial assets which can be channelized for funding purposes
  - Hedging mechanism to mitigate forex risk is not available for tenor greater than 3-4 years; for longer tenors they attract very high premiums
  - Lack of derivative market and interest rate derivative market that implies that investors are unable to manage risks efficiently
- Low ratings of infrastructure SPV's due to lack of proven track records and strong balance sheets
- Banks alone cannot meet the future financing requirements of the infrastructure sector

Key Challenges for Infrastructure Development (2/2)

- Lack of liquidity for long term bonds
  - Dominated by public borrowings; minimal participation by players who have access to long term sources
- Highly regulated investment norms
  - Pension funds and Insurance companies have access to long term funds which can be deployed for long term financing. However,
    - As per IRDA guidelines, the rating quality of investment bonds should not be less than AA whereas a typical non recourse infrastructure project is rated BB
    - Similarly, PFRDA mandates at least 75% of investments made in credit risk bearing fixed income instruments to be made in instruments having an investment grade rating
  - Tighter prudential limits on bank lending to NBFCs have limited their infrastructure investment growth

Capital scarcity has emphasized the need to financial innovation

TOOLS FOR LONG TERM INFRASTRUCTURE FUNDING

- Mini-Perm Financing
- Credit Enhancement
- Infrastructure Development Fund
- ECA / Multilateral Agencies
- Specialized Financing Institutions

1. Specialized Financing Institutions

- Key Players
  - India Infrastructure Finance Company (IIFCL), Rural Electrification Corporation (REC), Power Finance Corporation (PFC), Indian Railway Finance Corporation (IRFCL), Infrastructure Development Finance Corporation (IDFC)
- Governed by Ministry of Finance, Government of India
- Key Features
  - Source of funds are long term bond issuances guaranteed by the government or forex reserves in case of IIFCL
    - Recent regulatory changes have allowed these institutions to access foreign capital via ECB upto 75 % of owned funds
  - Higher expertise in project evaluation & structuring as compared to banks thus requiring long & detailed appraisal process
  - More flexibility in providing structured solutions to projects
  - Greater ability to manage the credit exposure and asset-liability duration mismatch
  - Competitive pricing is possible

It can play a key role in Infrastructure development with focus on specific sectors

2. ECA / Multilateral Agencies

- Key Players
  - Export Credit Agencies of various countries like Korea Exim bank (K-Exim) , US-Exim, Japan Bank for International Co-operation (JBIC), Export Development Canada, etc.
  - MLA Funding - International Finance Corporation (Investment Banking arm of World Bank) & Asian Development Bank
- Investment in domestic projects governed by ECB guidelines issued by RBI
- Key Features
  - Supplier’s country specific : Quantum may be restricted to Capex import component
  - Funding in the form of Direct Lending or through intermediary banks/institutes
  - Long tenor loan up to 14 years with competitive pricing generally lower than ECB by about 50 bps is possible
  - Require long & detailed appraisal process taking requires 9 to 12 months
  - Emphasis on equator principle
    - Voluntary set of principles for assessing and managing social and environmental risk in project finance
  - Political Risk Insurance (PRI) cover may be required in case of ECA

3. Infrastructure Debt Fund (1/2)

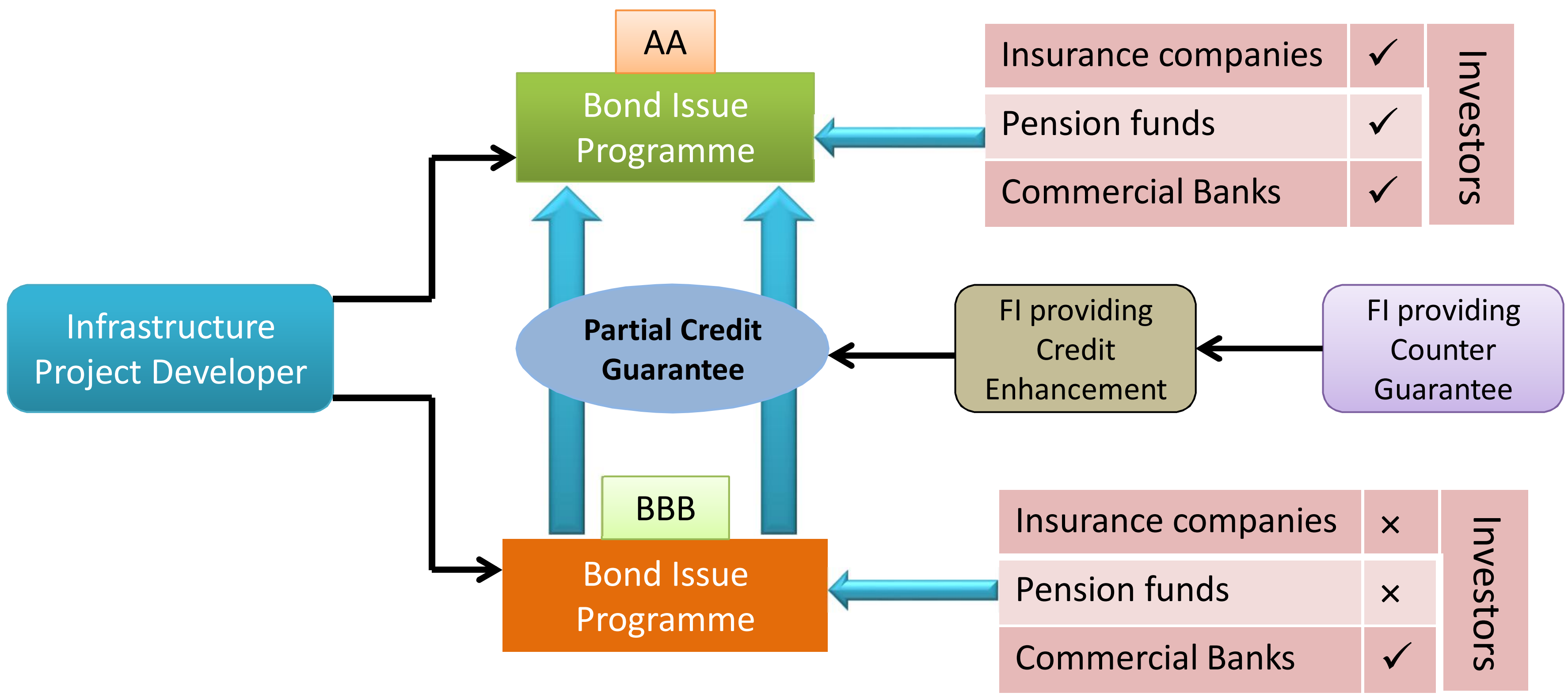
- Key Players : Banks, NBFCs and Mutual Funds
- Governed by :
  - Bonds issued under trust route as mutual funds (IDFs-MF) regulated by SEBI
    - Scheme should have a minimum maturity of 5 years
  - Bonds issued under corporate route as NBFCs (IDFs-NBFC) are regulated by RBI
    - NBFCs are required to be in existence for at least five years
- Existing IDFs in India
  - There are four IDFs registered with SEBI
    - ICICI Prudential Infrastructure Debt Fund, Birla Sunlife Infrastructure Debt Fund, IDBI Infrastructure Debt Fund & IDFC Infrastructure Debt Fund
  - IL&FS Infrastructure Debt Fund & India Infra Debt (the first Infrastructure Debt Fund under the NBFC Structure) was launched in February 2013

3. Infrastructure Debt Fund (2/2)

- Key Features
  - Potential source of funds would mainly include off-shore and domestic institutional investors, off-shore HNIs and NRIs ; Insurance & Pension Funds are sources but require approvals
  - They can invest in SPVs to refinance bank loans for existing and revenue generating infrastructure projects
  - Financing possible only after 1 year of commercial operation with projects having minimum credit rating 'A' or equivalent
    - Once construction is complete project risk would substantially come down, improving the credit rating
  - Banks will take the initial risk and then pass it on to IDFs
    - A major portion of the banks funds deployed in the project will get released and will be available for further advances

4. Credit Enhancement (1/2)

Credit Enhancement Structure



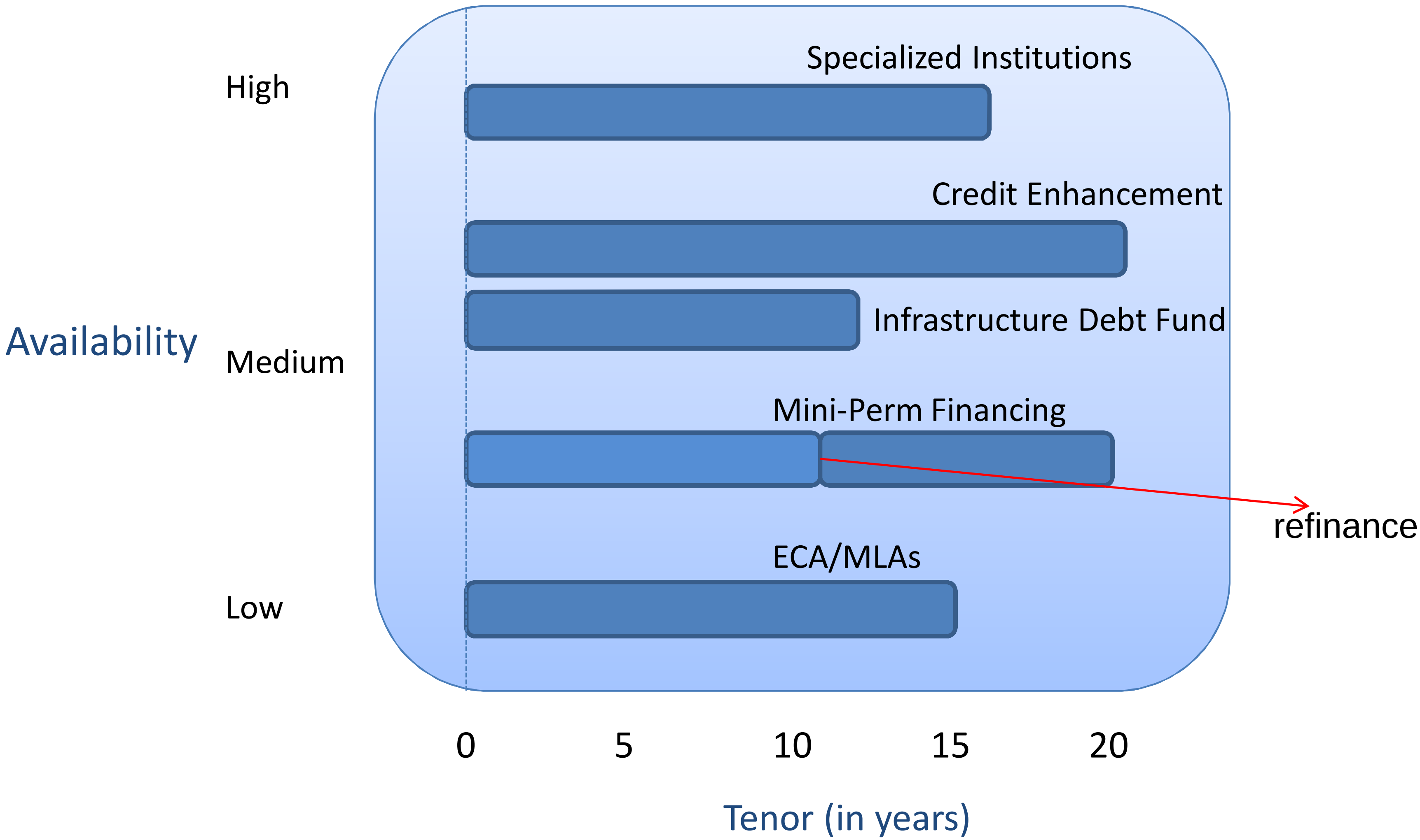
4. Credit Enhancement (2/2)

- Key Players
  - Infrastructure Finance Companies (such as IIFCL, PFC etc.) and Banks
  - Union Budget 2013-14 announced that IIFCL, in partnership with the ADB, will offer credit enhancement to infrastructure SPVs that wish to access the bond market to tap long term funds
    - Credit rating of the infrastructure project should be at least ‘BBB’ (before credit enhancement)
    - ADB has committed $ 128 m to guarantee facility for credit enhancement of project bonds in India
- Key Features
  - Provides full or partial credit guarantee to enhance the credit rating of bonds of infrastructure firms
  - The improved credit rating will help to channelize funds from untapped sources such as insurance companies and pension funds
  - The tenor for the bond issuance can be up to 12-15 years depending on the Project
  - The government has allowed private firms to issue infrastructure bonds; credit enhancement will help in the development of the corporate bond market
  - Provides adequate security comfort to lenders for extending debt

5. Mini-Perm Financing

- Key Players : Banks and Infrastructure Finance Companies
- Key Features
  - Short for mini permanent loans, to finance infrastructure and commercial real estate development projects
  - Generally, taken at the beginning of the project; once the project is completed the borrower can look for more long term financing solution
  - Two types of mini-perm financing are available :
    - Hard Mini-Perm : Short-term maturity viz. typically around 7 years requiring mandatory refinance thereafter
    - Soft Mini-Perm : Long term maturity viz. typically around 20 years, but includes incentives to encourage the borrower to refinance ; Most favored by the market
  - Soft mini-perms have been used on a few PFI projects in the UK

Summary



Availability
High
Medium
Low
Specialized Institutions
Credit Enhancement
Infrastructure Debt Fund
Mini-Perm Financing
refinance
ECA/MLAs
0
5
10
15
20
Tenor (in years)

Thank you

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