Sources of Infrastructure Funding

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Need for infrastructural development is of paramount importance and is *sine quo non* to the growth and development of an economy. The government recognizes the need it has been one of the priority agendas in the recent five year plans.

For 2011-12, government made an allocation of over Rs. 2,14,000 crore for this sector, amounting to 48.5 per cent of the Gross Budgetary Support to plan expenditure, which is 23.3 per cent higher than current year.

During the preliminary assessment of investment in infrastructure in the Twelfth Plan (2012-17), Planning Commission has projected investment requirement to be Rs. 40,99,240 crore, which would be twice the investments for the Eleventh Plan and estimates infrastructure spending of $1 trillion. The numbers clearly indicate that there has been a rise in infrastructure development and with the growing need for infrastructural development there would be need for rise in sources of funding as well.

Infrastructure funding is characterized by non recourse or limited recourse funding, large scale investment, long gestation period, high initial capital, low operating cost, repayments from the revenues generated from the project. Typically government has been the sole financier for these projects and has been responsible for implementation, operations and maintenance of these projects. However government solely will not be able to meet the rising funding requirements.

Thus the government has been inviting private participation in funding capacity building by way of Public Private Partnerships (PPP), commercial banks lending, take out financing, infrastructure financing institutions, infrastructure debt funds, external commercial borrowing, foreign direct investments etc and has been extending tax holidays to make funding feasible for lenders and borrowers. To stimulate public investment in infrastructure, a special purpose vehicle – India Infrastructure Finance Company Limited (IIFCL) was set up for providing long-term financial assistance to infrastructure projects.

It is estimated that more than half of the total estimated resource flows are likely to come from bank credit, while close to 15 per cent is estimated to come from external commercial borrowings. The resource flow from pension/insurance companies, which is potentially a high source of long term debt, is expected to provide resources by less than 7 per cent.

TABLE 12.7
Likely Sources of Debt

(Rs crore at 2006–07 price)

		2007–08	2008–09	2009–10	2010–11	2011–12	Total Eleventh Plan
1	Domestic Bank Credit	49848	63207	80147	101626	128862	423691
2	Non-Bank Finance Companies	23852	31485	41560	54859	72415	224171
3	Pension/Insurance Companies	9077	9984	10983	12081	13289	55414
4	External Commercial Borrowing (ECB)	19593	21768	24184	26868	29851	122263
5	Likely Total Debt Resources	102370	126444	156874	195435	244416	825539
6	Estimated Requirement of Debt (from Table 12.6)	131718	155704	187333	229571	283709	988035
	US$ Billion	32.93	38.93	46.83	57.39	70.93	247.01
7	Gap between Estimated Requirement and Likely Debt Resources (6–5)	29348	29260	30460	34136	39292	162496
	US$ Billion	7.34	7.31	7.61	8.53	9.82	40.62

Source: Computations of the Planning Commission.

Apart from the government addressing the needs for financing infrastructural developments, it has been looking at viable and feasible options to generate finances for this sector. Some of the sources of infrastructure funding are as mentioned below:

Public Private Partnership

The PPP is defined as "*the transfer to the private sector of investment projects that traditionally have been executed or financed by the public sector*" (IMF, 2004).

According to Ministry of Finance Government of India the PPP project means a project based on a contract or concession agreement, between Government or statutory entity on the one side and a private sector company on the other side, for delivering infrastructure service on payment of user charges. The PPP model helps government implement its schemes in partnership with the private sector. Typically these are set up in a form of a Special Purpose Vehicle and are engaged in financing, operating and maintaining of the assets and project.

Bank Financing

Bank credit to the infrastructure sector increased steadily from Rs. 7,243 crore in 1999–2000 to Rs. 2,69,972 crore in 2008–09, a compounded annual growth of 43.6 per cent. However, with bank fundings there is an issue of asset liability mismatch, as infrastructure requires long term funding and the deposits of banks are short term in nature. Thus the need for developing the long term debt financing market was felt much and India Infrastructure Finance Company Limited (IIFCL) was formed.

India Infrastructure Finance Company Limited (IIFCL)

IIFCL an SPV, was incorporated in Jan, 2006, by the Central Government for providing long term loans for financing infrastructure projects, providing financial assistance up to 20% of the project costs, both through direct lending to project companies and by refinancing banks and

financial institutions. IIFCL has raised Rs. 20,569 crore and approved 139 projects involving total investment of Rs. 2,00,884 crore by May 2010.

Infrastructure Finance Companies (IFCs)

RBI in 2010 notified a new category of NBFCs-ND-SI that are engaged predominantly in infrastructure financing as Infrastructure Finance Companies (IFCs)[1] An IFC is defined as non deposit taking NBFC that fulfills the criteria mentioned below:

i. a minimum of 75 per cent of its total assets should be deployed in infrastructure loans as defined in Para 2(viii) of the Non Banking Financial (Non Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;
ii. not accept deposits from public
iii. Net owned funds of Rs. 300 crore or above;
iv. minimum credit rating 'A' or equivalent of CRISIL, FITCH, CARE, ICRA or equivalent rating by any other accrediting rating agencies
v. CRAR of 15 percent (with a minimum Tier I capital of 10 percent)

Infrastructure Finance Companies (IFCs), are permitted to avail of ECBs, including the outstanding ECBs, up to 50 per cent of their owned funds, for on-lending to the infrastructure sector as defined under the ECB policy. ECB beyond 50 per cent of the owned funds by financial institutions which are classified as Infrastructure Finance Companies are considered on a case to case basis.

Foreign Direct Investment

Investment in infrastructure companies in the Securities Market

Foreign investment is permitted in infrastructure companies in Securities Markets, namely, stock exchanges, depositories and clearing corporations, in compliance with SEBI Regulations and subject to the following conditions:

i. There is a composite ceiling of 49 per cent for Foreign Investment, with a FDI limit of 26 per cent and an FII limit of 23 per cent of the paid-up capital;
ii. FDI will be allowed with specific prior approval of FIPB; and
iii. FII can invest only through purchases in the secondary market.

100% FDI is allowed under the Automatic Route in Development of townships, Housing, Built up infrastructure and Construction Development Projects but does not include real estate business. These norms are applicable, subject to conditions vide para 5.2.13 of Consolidated FDI policy of Government of India[2] including:

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[1] RBI notification dated 12th February, 2010, **RBI/2009-10/316 DNBS.PD. CC No.168/03.02.089 /2009-10**

[2] Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, GoI, Consolidated FDI Policy (effective from 1st April, 2011) http://dipp.nic.in/Fdi_Circular/FDI_Circular_012011_31March2011.pdf

a. Minimum capitalization of US$ 10 million for wholly owned subsidiaries and US$ 5 million for joint venture. The funds would have to be brought within six months of commencement of business of the Company.
b. Minimum area to be developed under each project- 10 hectares in case of development of serviced housing plots; and built-up area of 50,000 sq. mts. in case of construction development project; and any of the above in case of a combination project
c. Original investment cannot be repatriated before a period of three years from completion of minimum capitalization. Original investment means the entire amount brought in as FDI. The lock-in period of three years will be applied from the date of receipt of each installment/tranche of FDI or from the date of completion of minimum capitalization, whichever is later. However, the investor may be permitted to exit earlier with prior approval of the Government through the FIPB.
d. At least 50% of the project must be developed within the period of five years from the date of obtaining all statutory clearances. The investor/ investee company would not be permitted to sell undeveloped plots. For the purposed of these guidelines, "undeveloped plots" would mean where roads, water supply, street lighting, drainage, sewerage, and other conveniences, as applicable under the prescribed regulations, have not been made available. It will be necessary that the investor provides this infrastructure and obtains the completion certificate from the local body/ service agency before he would be allowed to dispose of services housing plots.
e. The project shall conform to the norms and standards, including land use requirements and provision of community amenities and common facilities, as laid down in the applicable building control regulations, bye-laws, rules, and other regulations of the State Government/Municipal/Local Body concerned.
f. The investor/ investee company shall be responsible for obtaining all necessary approvals, including those of the building/ layout plans, developing internal and peripheral areas and other infrastructure facilities, payment of development, external development and other charges and complying with all other requirements as prescribed under applicable rules/ bye-laws/ regulations of the State Government/ Municipal/ Local Body concerned.
g. The State Government/ Municipal/ Local Body concerned, which approves the building/ development plans, would monitor compliance of the above conditions by the developer.

The above conditions are not applicable for investments by NRIs or investments in SEZs, hotels and hospitals

Foreign Institutional Investors investment

The planning commission estimates that there is a gap of $100 billion in infrastructure funding that needs to be bridged from foreign sources. To enhance the flow of funds to the infrastructure sector, the FII limit for investment in corporate bonds, with residual maturity of over five years issued by companies in infrastructure sector, is being raised by an additional limit of US$ 20 billion taking the limit to US$ 25 billion. This will raise the total limit available to the FIIs for investment in corporate bonds to US$ 40 billion. Since most of the infrastructure companies are organised in the form of SPVs, FIIs would also be permitted to invest in unlisted bonds with a

minimum lock-in period of three years. However, the FIIs will be allowed to trade amongst themselves during the lock-in period.

Infrastructure Bonds

The infrastructure bonds have a maturity of 10 years but a lock-in period of five years and the investor has the option to sell the bonds back to the issuer. Alternatively, the bonds can be traded on the stock exchanges. What makes these bonds lucrative for investors and issuers is a) Section 80CCF, any individual or Hindu undivided family can invest up to Rs 20,000 in infrastructure bonds and avail of tax benefits b) these provide fixed returns and are reasonably safe and c) the amount raised by issue of infrastructure bonds by Infrastructure Finance Companies, u/s 80CCF of the Income Tax Act, 1961, shall not be treated as 'public deposit' as provided in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.

Infrastructure Debt Funds

A concept paper on creation of a Debt fund for Infrastructure PPP projects was presented by Shri Gajendra Haldea, Adviser to Deputy Chairman in a meeting of experts and stakeholders, held on May 12, 2010 under the chairmanship of Deputy Chairman Planning Commission. The paper suggested the creation of the India Infrastructure Debt Fund that would raise low-cost long-term resources for re-financing infrastructure projects that are past the construction stage and associated risks.

A Report on India Infrastructure Debt Fund, under the Chairmanship of Mr. Deepak Parekh made recommendations on setting up of Infrastructure Debt Funds[3] for Rs. 50,000 crore ($ 11 billion) to meet the needs of long-term debt for infrastructure projects that are set up through Public Private Partnerships (PPP).

Some of the recommendations in the report are:

- The holders of such long-term debt would be insurance and pension funds (including provident funds), both Indian as well as foreign.
- The Fund would be set up by one or more sponsors (the "Sponsor"), who will act as the General Partners of the Fund.
- The Sponsors would be required to invest at least 10% of the total investment in the form of subordinated debt.
- Any infrastructure project which is based on Public Private Partnership (PPP) where a public authority has provided for a compulsory buy-out of the project on payment of a pre-determined termination payment shall be eligible to borrow from the Fund.
    - The eligibility would be restricted to projects which have completed at least one year from their entry into commercial service, i.e., their commercial operation

[3] http://infrastructure.gov.in/pdf/INDIA%20INFRASTRUCTURE%20DEBT%20FUND%20010610%20CLEAN.pdf

date (COD), without any material default in debt service or in the performance of their obligations under the respective project agreements.
    - Projects other than PPP will not be eligible for borrowing from the Fund as they do not carry a compulsory buy-out guarantee from a public authority and therefore, pose risks that the Fund may not be able to manage.
- The Fund will issue negotiable bonds to its investors. The Fund will endeavor to earn a long-term spread of about 100 basis points above the rate of interest paid by the Fund to its investors.

In order to, provide impetus to overseas borrowing by facilitating infrastructure debt funds, the provisions of finance bill relating to direct taxes seek to amend the Income Tax Act, 1961, and state the following amendments:

- In case of interest income paid to the non-resident by a notified infrastructure debt fund, the rates of deduction would be provided in the proposed new section 194LB [at the rate of 5%]
- Further Section 10 of the Income Tax Act, is proposed to be amended by which income of any infrastructure debt fund notified by the Central Government shall be exempt from taxes but will be required to file a return of income.
- Further Section 115A of the Income Tax Act is proposed to be amended to provide that any income received by non-resident from notified infrastructure debt fund shall be taxable at 5% on the gross amount of such interest income. The amendments are proposed to be effective from 1st June, 2011

Take out financing

Takeout finance is the product emerging in the context of the funding of long-term infrastructure projects. Under this arrangement, the institution/the bank financing infrastructure projects will have an arrangement with any financial institution for transferring to the latter the outstanding in respect of such financing in their books on a predetermined basis. In view of the time lag involved in taking-over, the possibility of a default in the meantime cannot be ruled out. The norms of asset classification will have to be followed by the concerned bank/financial institution in whose books the account stands as balance sheet item as on the relevant date. If the lending institution observes that the asset has turned NPA on the basis of the record of recovery, it should be classified accordingly. The lending institution should not recognise income on accrual basis and account for the same only when it is paid by the borrower/ taking over institution (if the arrangement so provides). The lending institution should also make provisions against any asset turning into NPA pending its take over by taking over institution. As and when the asset is taken over by the taking over institution, the corresponding provisions could be reversed. However, the taking over institution, on taking over such assets, should make provisions treating the account as NPA from the actual date of it becoming NPA even though the account was not in its books as on that date.[4]

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[4] Master Circular - Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances, July, 2010 http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=5781#L32

Take out financing approved through ECB route.

Refinancing of domestic Rupee loans with ECB was not permitted. However, keeping in view the special funding needs of the infrastructure sector, RBI decided to review the ECB policy and put in place a scheme of take-out finance.

Take-out financing arrangement through ECB is permitted[5], under the approval route, for refinancing of Rupee loans availed of from the domestic banks by eligible borrowers in the sea port and airport, roads including bridges and power sectors for the development of new projects, subject to the following conditions:

a. The corporate developing the infrastructure project should have a tripartite agreement with domestic banks and overseas recognized lenders for either a conditional or unconditional take-out of the loan within three years of the scheduled Commercial Operation Date (COD). The scheduled date of occurrence of the take-out should be clearly mentioned in the agreement.
b. The loan should have a minimum average maturity period of seven years.
c. The domestic bank financing the infrastructure project should comply with the extant prudential norms relating to take-out financing.
d. The fee payable, if any, to the overseas lender until the take-out shall not exceed 100 bps per annum.
e. On take-out, the residual loan agreed to be taken- out by the overseas lender would be considered as ECB and the loan should be designated in a convertible foreign currency and all extant norms relating to ECB should be complied with.
f. Domestic banks / Financial Institutions will not be permitted to guarantee the take-out finance
g. The domestic bank will not be allowed to carry any obligation on its balance sheet after the occurrence of the take-out event.
h. Reporting arrangement as prescribed under the ECB policy should be adhered to.

Road Ahead

The government has proposed to come out with Infrastructure debt funds regulations by June, 2011. Regulations with regard to insurance and pension funds need to be relaxed in view of enabling the requisite flow of investments in the proposed Debt Fund. Positive steps have been taken for bridging the funding gap for the fast growing sector and shall contribute to the economic development of the country.

[5] RBI Circular dated 22nd July, 2010, http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/ADI04F220710.pdf