Guidelines on infrastructure financing

DBOD. No. BP. BC. 67 / 21.04.048/ 2002- 2003

February 4, 2003

All Scheduled Commercial Banks
(excluding RRBs & LABs) &
All India Financial Institutions

Dear Sir,

Guidelines on infrastructure financing

Please refer to our Industrial & Export Credit Department's Circular No. 16/ 08.12.01/ 2001-02 dated 20 February 2002 on financing of infrastructure projects. RBI has been receiving requests in the recent past suggesting a need for review of guidelines on infrastructure financing by banks. In view of the above as also the critical importance of the infrastructure sector and high priority being accorded for development of various infrastructure services, the matter has been reviewed in consultation with Government of India and the revised guidelines on financing of infrastructure projects are set out in the Annexure.

2. Please acknowledge receipt.

Yours faithfully,

(C. R. Muralidharan)
Chief General Manager

Annexure

Guidelines for Financing of Infrastructure Projects

1. Definition of 'infrastructure lending'

Any credit facility in whatever form extended by lenders (i.e. banks, FIs or NBFCs) to an infrastructure facility as specified below falls within the definition of "infrastructure lending". In other words, a credit facility provided to a borrower company engaged in:

- developing or
- operating and maintaining, or
- developing, operating and maintaining

any infrastructure facility that is a project in any of the following sectors:

i) a *road*, including *toll road*, a *bridge* or a *rail system*;

ii) a *highway project* including other activities being an integral part of the highway project;

iii) a *port*, *airport*, *inland waterway* or *inland port*;

iv) a *water supply* project, *irrigation* project, *water treatment* system, *sanitation and sewerage* system or *solid waste management* system;

v) *telecommunication* services whether basic or cellular, including radio paging, domestic *satellite service* (i.e., a satellite owned and operated by an Indian company for providing telecommunication service), *network of trunking, broadband network and internet services*;

vi) an *industrial park or special economic zone* ;

vii) *generation or generation and distribution of power*

viii) *transmission or distribution of power* by laying a network of new transmission or distribution lines.

ix) Any other infrastructure facility of similar nature

2. Criteria for Financing

Banks/FIs are free to finance technically feasible, financially viable and bankable projects undertaken by both public sector and private sector undertakings subject to the following conditions:

(i) The amount sanctioned should be within the overall ceiling of the prudential exposure norms prescribed by RBI for infrastructure financing (please see paragraph 5.1 also).

(ii) Banks/ FIs should have the requisite expertise for appraising technical feasibility, financial viability and bankability of projects, with particular reference to the risk analysis and sensitivity analysis (please see paragraph 4 also).

(iii) In respect of projects undertaken by public sector units, term loans may be sanctioned only for corporate entities (i.e. public sector undertakings registered under Companies Act or a Corporation established under the relevant statute). Further, such term loans should not be in lieu of or to substitute budgetary resources envisaged for the project. The term loan could supplement the budgetary resources if such supplementing was contemplated in the project design. While such public sector units may include Special Purpose Vehicles (SPVs) registered under the Companies Act set up for financing infrastructure projects, it should be ensured by banks and financial institutions that these loans/investments are not used for financing the budget of the State Governments. Whether such financing is done by way of extending loans or investing in bonds, banks and financial institutions should undertake due diligence on the viability and bankability of such projects to ensure that revenue stream from the project is sufficient to take care of the debt servicing obligations and that the repayment/servicing of debt is not out of budgetary resources. Further, in the case of financing SPVs, banks and financial institutions should ensure that the funding proposals are for specific monitorable projects .

(iv) Banks may also lend to SPVs in the private sector, registered under Companies Act for directly undertaking infrastructure projects which are financially viable and not for acting as mere financial intermediaries. Banks may ensure that the bankruptcy or financial difficulties of the parent/ sponsor should not affect the financial health of the SPV.

3. Types of Financing by Banks

3.1 In order to meet financial requirements of infrastructure projects, banks may extend credit facility by way of working capital finance, term loan, project loan, subscription to bonds and debentures/ preference shares/ equity shares acquired as a part of the project finance package which is treated as "deemed advance" and any other form of funded or non-funded facility.

3.2 Take-out Financing

Banks may enter into take-out financing arrangement with IDFC/ other financial institutions or avail of liquidity support from IDFC/ other FIs. A brief write-up on some of the important features of the arrangement is given in the Appendix. Banks may also be guided by the instructions regarding take-out finance contained in Circular No. DBOD. BP. BC. 144/ 21.04.048/ 2000 dated 29 February 2000.

3.3 Inter-institutional Guarantees

In terms of the extant RBI instructions, banks are precluded from issuing guarantees favouring other banks/lending institutions for the loans extended by the latter, as the primary lender is expected to assume the credit risk and not pass on the same by securing itself with a guarantee i.e. separation of credit risk and funding is not allowed. These instructions are presently not applicable to FIs. While Reserve Bank is not in favour of a general relaxation in this regard, keeping in view the special features of lending to infrastructure projects viz., high degree of appraisal skills on the part of lenders and availability of resources of a maturity matching with the project period, banks are permitted to issue guarantees favouring other lending institutions in respect of infrastructure projects, provided the bank issuing the guarantee takes a funded share in the project at least to the extent of 5 per cent of the project cost and undertakes normal credit appraisal, monitoring and follow up of the project.

3.4 Financing promoter's equity

In terms of our Circular DBOD. Dir. BC. 90/ 13.07.05/ 98 dated 28 August 1998, banks were advised that the promoter's contribution towards the equity capital of a company should come from their own resources and the bank should not normally grant advances to take up shares of other companies. In view of the importance attached to infrastructure sector, it has been decided that, under certain circumstances, an exception may be made to this policy for financing the acquisition of promoter's shares in an existing company which is engaged in implementing or operating an infrastructure project in India. The conditions, subject to which an exception may be made are as follows:

(i) The bank finance would be only for acquisition of shares of existing companies providing infrastructure facilities as defined in paragraph 1 above. Further, acquisition of such shares should be in respect of companies where the existing foreign promoters (and/ or domestic joint promoters) voluntarily propose to disinvest their majority shares in compliance with SEBI guidelines, where applicable.

(ii) The companies to which loans are extended should, inter alia, have a satisfactory net worth.

(iii) The company financed and the promoters/ directors of such companies should not be defaulter to banks/ FIs.

(iv) In order to ensure that the borrower has a substantial stake in the infrastructure company, bank finance should be restricted to 50% of the finance required for acquiring the promoter's stake in the company being acquired.

(v) Finance extended should be against the security of the assets of the borrowing company or the assets of the company acquired and not against the shares of that company or the company being acquired. The shares of borrower company / company being acquired may be accepted as additional security and not as primary security. The security charged to the banks should be marketable.

(vi) Banks should ensure maintenance of stipulated margin at all times.

(vii) The tenor of the bank loans may not be longer than seven years. However, the Boards of banks can make an exception in specific cases, where necessary, for financial viability of the project.

(viii) This financing would be subject to compliance with the statutory requirements under Section 19(2) of the Banking Regulation Act, 1949.

(ix) The banks financing acquisition of equity shares by promoters should be within the regulatory ceiling of 5 per cent on capital market exposure in relation to its total outstanding advances (including commercial paper) as on March 31 of the previous year.

(x) The proposal for bank finance should have the approval of the Board.

4. Appraisal

(i) In respect of financing of infrastructure projects undertaken by Government owned entities, banks/Financial Institutions should undertake due diligence on the viability of the projects. Banks should ensure that the individual components of financing and returns on the project are well defined and assessed. State Government guarantees may not be taken as a substitute for satisfactory credit appraisal and such appraisal requirements should not be diluted on the basis of any reported arrangement with the Reserve Bank of India or any bank for regular standing instructions/periodic payment instructions for servicing the loans/bonds.

(ii) Infrastructure projects are often financed through Special Purpose Vehicles. Financing of these projects would, therefore, call for special appraisal skills on the part of lending agencies. Identification of various project risks, evaluation of risk mitigation through appraisal of project contracts and evaluation of creditworthiness of the contracting entities and their abilities to fulfil contractual obligations will be an integral part of the appraisal exercise. In this connection, banks/FIs may consider constituting appropriate screening committees/special cells for appraisal of credit proposals and monitoring the progress/performance of the projects. Often, the size of the funding requirement would necessitate joint financing by banks/FIs or financing by more than one bank under consortium or syndication arrangements. In such cases, participating banks/ FIs may, for the purpose of their own assessment, refer to the appraisal report prepared by the lead bank/FI or have the project appraised jointly.

5. Prudential requirements

5.1 Prudential credit exposure limits

Credit exposure to borrowers belonging to a group may exceed the exposure norm of 40 per cent of the bank's capital funds by an additional 10 per cent (i.e up to 50 per cent), provided the additional credit exposure is on account of extension of credit to infrastructure projects. Credit exposure to single borrower may exceed the exposure norm of 15 per cent of the bank's capital funds by an additional 5 per cent (i.e. up to 20 per cent) provided the additional credit exposure is on account of infrastructure as defined in paragraph 1 above.

5.2 Assignment of risk weight for capital adequacy purposes

Banks may assign a concessional risk weight of 50 per cent for capital adequacy purposes, on investment in securitised paper pertaining to an infrastructure facility subject to compliance with the following :

a) The infrastructure facility should satisfy the conditions stipulated in paragraph 1 above.
b) The infrastructure facility should be generating income/ cash flows which would ensure servicing/ repayment of the securitised paper.
c) The securitised paper should be rated at least 'AAA' by the rating agencies and the rating should be current and valid. The rating relied upon will be deemed to be current and valid if :
    (i) The rating is not more than one month old on the date of opening of the issue, and the rating rationale from the rating agency is not more than one year old on the date of opening of the issue, and the rating letter and the rating rationale is a part of the offer document.

    (ii) In the case of secondary market acquisition, the 'AAA' rating of the issue should be in force and confirmed from the monthly bulletin published by the respective rating agency.

    (iii) The securitised paper should be a performing asset on the books of the investing/ lending institution.

5.3 Asset - Liability Management

The long - term financing of infrastructure projects may lead to asset – liability mismatches, particularly when such financing is not in conformity with the maturity profile of a bank’s liabilities. Banks would, therefore, need to exercise due vigil on their asset-liability position to ensure that they do not run into liquidity mismatches on account of lending to such projects.

6. Administrative arrangements

Timely and adequate availability of credit is the pre-requisite for successful implementation of infrastructure projects. Banks/ FIs should, therefore, clearly delineate the procedure for approval of loan proposals and institute a suitable monitoring mechanism for reviewing applications pending beyond the specified period. Multiplicity of appraisals by every institution involved in financing, leading to delays, has to be avoided and banks should be prepared to broadly accept technical parameters laid down by leading public financial institutions. Also, setting up a mechanism for an ongoing monitoring of the project implementation will ensure that the credit disbursed is utilised for the purpose for which it was sanctioned.

APPENDIX

Take-out financing/liquidity support

a. Take-out financing arrangement

Take-out financing structure is essentially a mechanism designed to enable banks to avoid asset-liability maturity mismatches that may arise out of extending long tenor loans to infrastructure projects. Under the arrangements, banks financing the infrastructure projects will have an arrangement with IDFC or any other financial institution for transferring to the latter the outstandings in their books on a pre-determined basis. IDFC and SBI have devised different take-out financing structures to suit the requirements of various banks, addressing issues such as liquidity, asset-liability mismatches, limited availability of project appraisal skills, etc. They have also developed a Model Agreement that can be considered for use as a document for specific projects in conjunction with other project loan documents. The agreement between SBI and IDFC could provide a reference point for other banks to enter into somewhat similar arrangements with IDFC or other financial institutions.

b. Liquidity support from IDFC

As an alternative to take-out financing structure, IDFC and SBI have devised a product, providing liquidity support to banks. Under the scheme, IDFC would commit, at the point of sanction, to refinance the entire outstanding loan (principal+unrecovered interest) or part of the loan, to the bank after an agreed period, say, five years. The credit risk on the project will be taken by the bank concerned and not by IDFC. The bank would repay the amount to IDFC with interest as per the terms agreed upon. Since IDFC would be taking a credit risk on the bank, the interest rate to be charged by it on the amount refinanced would depend on the IDFC's risk perception of the bank (in most of the cases, it may be close to IDFC's PLR). The refinance support from IDFC would particularly benefit the banks which have the requisite appraisal skills and the initial liquidity to fund the project.