How NBFCs can help meet infrastructure financing challenges

May 27, 2012: Understanding the contours of infrastructure financing has become increasingly relevant in the backdrop of the growth moderation in the Indian economy. We will soon see the unveiling of the 12{+t}{+h} Five-Year Plan, that is set to make a bold projection of investment in infrastructure aimed at returning India to higher levels of sustainable growth.Infrastructure investment as a share of GDP, was approximately 8 per cent at the end of FY12; over the next five years, it is expected to inch closer to 10 per cent of GDP. India is set to draw up a trillion-dollar road-map in the new Plan to create world-class infrastructure.This is an increase in spending of nearly 150 per cent over the 11{+t}{+h} Plan. Moreover, private sector contribution is expected to increase from Rs 6 lakh crore to Rs 21 lakh crore — a 250 per cent jump.With the government looking to adopt the public-private partnership structure in more sectors, the PPP framework will play a prominent role, given the need to build infrastructure quickly and the limited capital availability from budgetary sources. It has been observed that this framework is required to provide robust credit as well as a strong regulatory overlay to provide comfort to investors.

SHARE OF BANK FINANCING

A significant share (around 55 per cent) of the financing in the 11{+t}{+h} Plan that includes private and public projects has been provided by banks. However, the absolute quantum as a percentage of funds deployed will reduce as infrastructure financing is nearing 15 per cent of total bank credit and there is limited head-room for further loan growth in this category.Banks already have a large exposure to the sector with long-dated maturities and may not be keen to significantly enhance their exposure, given credit and asset-liability considerations. While relaxation of prudential norms (in terms of sectoral exposure) can provide a short-term fix, it may not be a wise solution.In addition, new capital adequacy requirements (set under Basel III) and potential deterioration in asset quality will increase the need of banks to raise capital in the near future to maintain growth in loan book.The need is to create credit institutions that can fill some of the gaps as well as enable long-term institutional funds to enter the market.Pension and insurance funds are the largest pools of long-term finance in India. However, they have not been able to participate in long-term finance to fund PPP projects, primarily because of regulatory restrictions (minimum rating requirements), shortage of quality paper, and the absence of deep bond markets.The outlook for raising capital from public markets, currently going

through a trough, is expected to recover in the medium term, in line with improvement in sentiment and outlook.Recently, there has been stress in a number of sectors related to infrastructure. This includes core infrastructure (power and roads), agriculture (food processing, storage and supply chain) and manufacturing. Most of the new investments are targeted in power sector (around 50 per cent increase in existing capacity in generation and T&D) and roads and highways (24,000 km of new roads). However, micro-issues in these sectors must be addressed first before significant additional fresh funds can be raised.A number of measures aimed at smoothing the flow of funds into infrastructure have been introduced that include a revised takeout scheme by IIFCL, introduction of CDS and establishment of the IFC-NBFC category.

IMPROVING THE SCENARIO There have also been a number of relaxations of norms related to attracting foreign capital to India, more specifically infrastructure sector.This includes ECB norms for infrastructure sector and IFCs, guidelines to set up IDF, increase in FII subscription to corporate and infrastructure sector bonds, and an increase in deposit rates for NRE accounts.Specialised infrastructure finance institutions such as IDFC and IIFCL have played a meaningful role in providing capital to infrastructure projects.The regulator has created an enabling framework for such institutions to participate in infrastructure growth with a mix of sector focussed institutions (such as IRFC, PFC, REC) as well as general purpose institutions.

ROLE OF NBFCS The creation of a separate category of NBFCS (NBFC-IFC) for infrastructure financing highlights the need for institutions with expertise in project evaluation and structuring, as well as the ability to manage the credit exposure and asset-liability duration mismatch. NBFCs can be expected to play a complementary role to banks as providers of infrastructure finance.In addition, NBFCs are capable of providing structured solutions and longer-term capital which can aid projects to achieve financial closure.Recent regulatory changes have allowed NBFCs to access foreign capital via external commercial borrowing and channel it to infrastructure projects. Dedicated infrastructure financing institutions are essential to channel long-term funds from abroad, both through the ECB route and direct financing through funds.