**RBI’s proposed framework to administer project financing**

The story so far:

To strengthen the existing regulatory framework around long-gestation period financing for projects in infrastructure, non-infrastructure and commercial real estate sectors, the RBI issued draft regulations for consultation earlier this month. Comments on the draft direction are solicited until June 15.

What is purpose of the framework?

Infrastructure projects usually have a long gestation period, with a higher probability of not being financially viable. Depending on scale and technology, these projects may require a loan with a longer tenure. Such projects may also face multiple obstacles leading to delays or cost-overruns. The Ministry of Statistics and Programme Implementation’s March review of 1,837 projects observed that 779 of them were delayed and 449 faced cost overruns. The review attributed the delay to land acquisition, obtaining forest/environment clearances, changes in scope (and size) etc. These factors are dampeners for banks, which would have priced the risks associated with the project in a certain way on their books.

What are the key revisions?

The RBI’s focus is on mitigating a ‘credit event’, that is, a default or a need to extend the original Date of Commencement of Commercial Operations (DCCO) or infuse additional debt, and/or diminution in the Net Present Value (NPV) of the project. One of the more important revisions concerns ‘provisioning’, that is, setting aside some money ahead of time to compensate for a potential loss. The proposed framework recommends that, at the construction stage (that is, when the financial assessment is finalised and before DCCO), a general provision of 5% is to be maintained on all existing and fresh exposures. This is a revision from the erstwhile 0.4%. According to CareEdge Ratings, this would “dampen the bidding appetite from infrastructure developers in the medium term”.

This 5% provisioning would be implemented in a phased manner.

What about prudential conditions?

The framework seeks that all mandatory pre-requisites must be in place before financial closure (that is, before the finalising of financial conditions). The indicative list must provide environmental, regulatory and legal clearances relevant to the project. The DCCO must be clearly spelt out. Financial disbursals would be made and the progress in equity infusion agreed to based on the stages of completion. The onus is on the bank to deploy an independent engineer or architect who would be responsible for certifying the project’s progress.

RBI proposes to mandate that a positive NPV be a prerequisite to obtain project finance. It also seeks that lenders get the project NPV independently re-evaluated every year. This is to help them avert the possibility of any build-up of stress and have an action plan in place.

Can repayment norms be revised?

Yes. However, the framework proposes that the original or revised repayment tenure, inclusive of the moratorium period, must not exceed 85% of the economic life of the project.

RBI’s proposed framework also recommends certain criteria for evaluating a change in repayment schedule due to an increase in the project outlay if there’s an increase in scope and size of the project. This revision will have to take place before the DCCO, after lenders offer a satisfactory re-assessment about the viability of the project, and if the risk in project cost, excluding any cost overrun, is 25% or more of the original outlay. Significantly, the framework also introduces guidelines to trigger a standby credit facility. This is to be sanctioned at the time of financial closure to fund overruns arising due to delays.

What have initial observations been?

Ratings agency ICRA observed in a report that higher provisioning requirement for projects under implementation would impact the near-term profitability of non-banking financial companies (and infrastructure financing companies). In their recent earnings call, the SBI, Union Bank of India and Bank of Baroda expressed confidence in the proposal not having any “significant” impact.