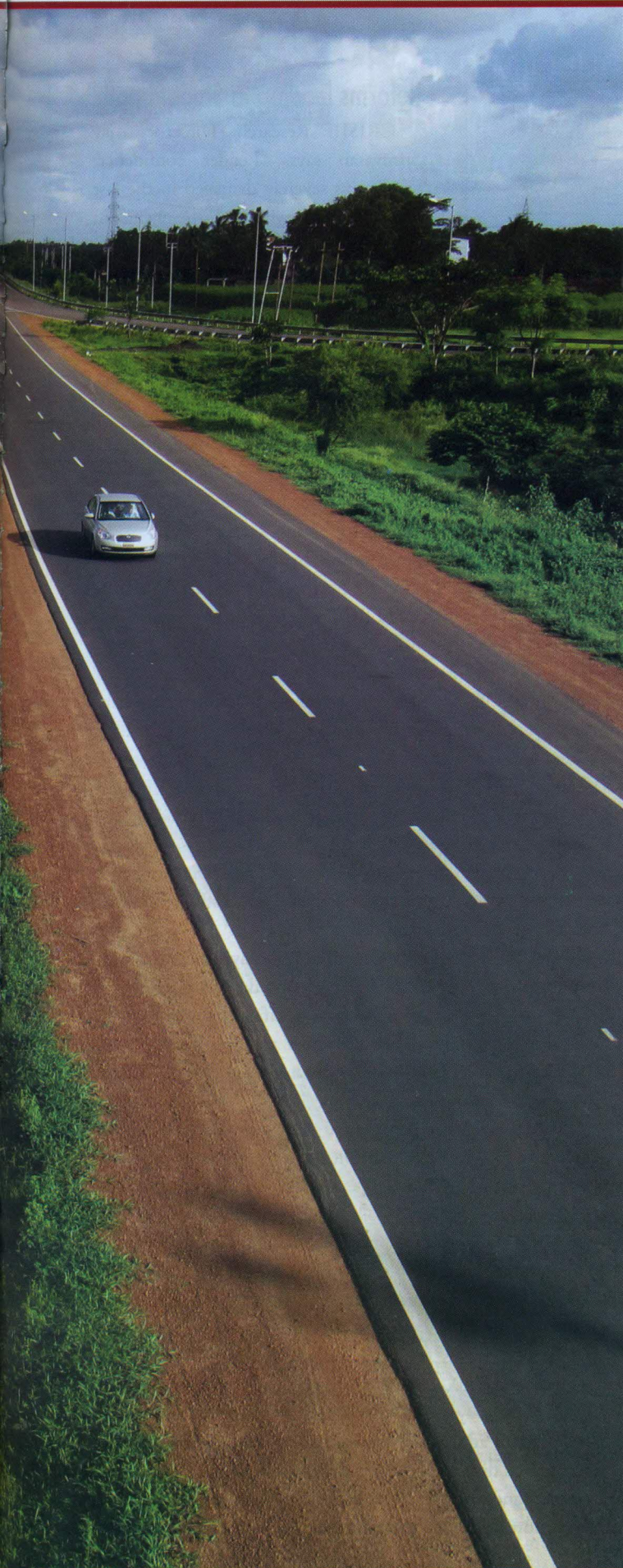


Roads on Roll

Being the second largest network of road in the world, the Indian road sector has gained momentum with the government's focus on breathing a new life in the sector through its reforms and policy measures. The announcement of Bharat Mala project, intentions of awarding 10,000 km of road projects this fiscal and announcement of new models will attract road developers after a lull in the sector.



Projects in Pipeline

Some of the key developments in the Indian roads sector are as follows:

- The government announced highway projects worth US\$ 93 billion, including the NHDP with an investment of US\$ 45 billion over the next three years
- The Ministry of Road Transport and Highways has undertaken development of about 7,000 km of national highways under Bharatmala Pariyojana at an estimated cost of ₹ 80,000 crore in consultation with state governments. National Highways Authority of India (NHAI) has invited bids for preparing Detailed Project Reports (DPR) for road development along the borders and coast lines under the Bharat Mala project
- The Cabinet Committee on Economic Affairs (CCEA) has permitted 100 per cent equity divestment by private developers after two years of construction completion for all Build-Operate-Transfer (BOT) projects, irrespective of the year of award of the project
- The government also approved the construction of around 1,000 km of expressways at a cost of ₹ 16.68 crore (US\$ 2.5 million) on a design-build-finance-operate-transfer (DBFOT) mode. The approved corridors are Delhi-Chandigarh (249 km), Bengaluru-Chennai (334 km), Delhi-Jaipur (261 km) and Vadodara-Mumbai (400 km)
- The government will also take up the development of 135 km long Eastern Peripheral Expressway at an estimated cost of ₹ 5,763 crore
- The Ministry of Road Transports and Highways plans to award 273 road projects covering a length of around 12,900 km at an estimated cost of ₹ 1,26,700 crore in FY 2015-16
- Government of Chhattisgarh is also planning to invest ₹ 9,500 crore to upgrade 44 roads in the state

The road infrastructure in place is the key to revival of economy. Any nation cannot tread the path of growth without proper connectivity. Having the potential for enhancing trade, the road network is necessary for the economic growth.

"American roads are good not because America is rich, but America is rich because American roads are." John F Kennedy.

How true is this saying!

The Indian road has been in the limelight with the government's emphasis on the revival of the investment cycle in the sector. In order to bring the sector on growth trajectory, the government has recently planned to award road projects worth ₹ 3.5 lakh crore. Further, the Road Transport and Highways Ministry has set the objective of constructing 30 km road per day within two years. The government's target of 273 road projects covers an approximate length of 12,900 km worth ₹ 1,26,700 crore in 2015-16. Moreover, the initiatives like the introduction of Hybrid Annuity Model and Swiss Challenge Model may rekindle private investments in the sector.

Further, the step of clearing amendments to the model concession agreement (MCA) in order to award projects on a build-operate-transfer (BOT) basis will stimulate the highways sector. CRISIL Research in its report mentions two changes including back ending of premium payments and deemed termination of projects are particularly significant. Allowing greater equity contribution by the authority is also another positive step.

Further, stringent penalties on non-compliance of maintenance contracts and collection of real-time traffic data would lend clarity and fix responsibility appropriately. These changes will improve the confidence of both developers and lenders in investing in the sector.



"The provisions under new MCA will address the issue of land acquisition to a large extent."

Bajrang Kumar Choudhary,
CEO - Infrastructure Project
Development, Srei Infrastructure
Finance Limited

Reforms leading to Smooth path

CRISIL Research Director Ajay Srinivasan says, "Lender confidence, which was severely damaged in the last few years, will revive with the change in the clause related to premium payment, and introduction of the clause on deemed termination. Further, doubling the cap on equity contribution by the NHAI will make more projects viable at a time when majority of the BOT projects being awarded are on a grant basis."

CRISIL considers the changes to the MCA, and to some policies earlier, have significantly improved the outlook on the national highways sector. "We expect project awards by the NHAI to increase nearly 50 per cent in fiscal 2016. The share of BOT projects, on the other hand, could rise from 25 per cent in fiscal 2015 to over 50 per cent by 2017. A significant

improvement in overall execution rates will happen gradually, over a couple of years. But things are definitely - and finally -- looking bright for India's highways sector," the report notes.

Bajrang Kumar Choudhary, CEO - Infrastructure Project Development, Srei Infrastructure Finance Limited states, "The provisions under new MCA will address the issue of land acquisition to a large extent." Srei has an execution experience of 14 road projects of about 5,412 lane km in PPP mode in both BOT and annuity model.

Under the amended MCA, premium payment starts only from the fourth year after the completion date compared with the first year previously. That's a significant relief to both developers and lenders because most projects end up with debt-service coverage ratio of less than 0.8-1.0 time in the first 3-4 years after completion date.

Moving further, the Centre has permitted the road developers to divest 100 per cent equity in projects two years after completion. According to India Ratings, twenty-odd road projects stretching over 1,500 km and being executed on a public-private partnership (PPP) basis may benefit immediately from this decision. The move will help financially-stressed private investors to unlock capital to the tune of ₹ 4,000 crore for future projects or to retire debt.

As per estimates of India Ratings, there are 86 projects equivalent to 5,200 km that have been completed (source: National Highways Authority of India) under PPP. Around ₹ 4,000 crore of additional residual equity can be released under the proposed divestment scheme. Previously, developers of road projects, signed before 2009, had to hold at least 26 per cent stake, a norm that tied them to these projects even if they had

Efficiency Parameters

Efficiency Parameters	Achievement During 2013-14	Target 2014-15
Average Construction of Road in km per day	11.67	17.26
Average award of works in km per day	8.68	23.28

(Source: MoRTH)

executed them. The latest decision permitting developers to divest 100 per cent equity would present a total opportunity to raise ₹ 15,000 crore through monetisation of completed assets.

The approval would allow developers to invest proceeds from the sale of divested equity in incomplete projects of NHAI or any other road projects. "This will result in physical completion of languishing infrastructure projects," the government said in a statement.

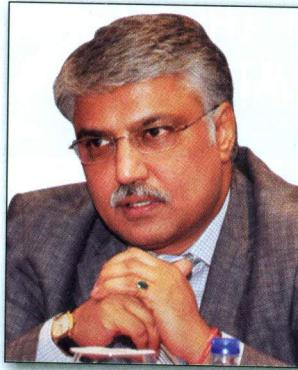
While terming the government's this step as a boost for enhancing the lender's comfort, Rajeev Bhatnagar, CEO-Highways, Feedback Infrastructure, says, "The government will help to unlock the equity which can be used for future bidding. Similar impact on equity will be by introducing of higher equity support. Delayed premium payments and availability of revenue shortfall loan can provide relief to cash strapped industry. Introducing deemed termination and the refinancing option is a step towards enhancing the lender's comfort.

Feasible Models

The government plans to spend as much as ₹ 1.2 trillion on national highways in the current financial year, with a target of awarding a total of 273 road projects. Most projects awarded, however, have been through the EPC (engineering, procurement, construction) route, where the financial commitment needed from developers is lower. In order to attract developers, the government announced it would award some of the projects on the Hybrid Annuity Model or on Swiss Challenge basis. These initiatives are likely to evoke interest from the industry players.

The government is planning different measures for bidding the road projects as per norms underlined in the 'Swiss Challenge System' to attract private sector participation. Under the Swiss Challenge System, private investors can draft a proposal of development and pursue it with the government for approval. It also allows third parties to make better offers for a project during a designated period to avoid exaggerated project development costs. The original promoter, however, is given the right of first refusal and the right to counter-match any superior offers given by the third party. The Swiss Challenge System has not proved to be very successful elsewhere as the private developer is required to make good initial investment, which will be difficult to recover unless it wins the contract.

The second model on which the government is planning to



"The government will help to unlock the equity which can be used for future bidding. Similar impact on equity will be by introducing of higher equity support."

Rajeev Bhatnagar,
CEO-Highways,
Feedback Infrastructure

award the road project is the 'Hybrid Annuity Model'. Under this model, higher proportion of risk will be covered by the government and the upfront funding required to be made by the private developer would be reduced. A number of projects lined up to be awarded this fiscal would be bid out under the Hybrid Annuity Model, under which the government would provide 40 per cent of project cost to the developer to start work. The remaining investment will have to be made by the developer. The NHAI will collect toll and refund the amount in installments to the developer over a period of 15-20 years. In this model, the risk of revenue collection is not associated with the developer and it also provides option to lend from banks as the return on investment is pre decided.

"Hybrid Annuity model is still at its nascent stage. Though the model apparently

looks very attractive from developers and lenders perspective, the contours of the model are yet to be evaluated. We have to wait for some more time to see how lenders respond to this model once a project takes off the ground," says Choudhary.

To this, D K Sen, Whole Time Director and Senior Executive Vice President (Infrastructure) Larsen & Toubro, feels, "The new Hybrid Annuity model should bring back private sector investments in the highway sector and, at the same time, obviate the need to balance two modes of contracting like PPP and EPC between private and government sector investments."

Stumbling blocks

According to the report of the Ministry of Statistics and Program Implementation (MoSPI), out of 36 roads projects, four projects are on schedule while 29 are delayed. The total

Targets and Performance

Parameter	Target (2014-15)	Achievement ((April - October, 2014)
Road length to be awarded	8,500	3,419
Completion of Construction	6,300	1,984

(Source: MoRTH)



original cost of these 36 projects is ₹ 55,380 crore while the anticipated completion cost is ₹ 56,560 crore, reflecting a cost overrun of 2.1 per cent (spread over all road sector projects). The expenditure incurred on these projects till March 2015 is ₹ 43,310.11 crore, which is 78.2 per cent of the original cost of the projects.

Industry pundits attribute the delay in these 29 projects to land acquisition, rehabilitation and resettlement, law and order problems, environment or wildlife and security clearances. There are also problems of geological uncertainties, increase in or change of scope of work, contractual disputes, non-performance or poor participation of the contractor. The availability of Right of Way at site is the most demanding concern for all project developers, as the authorities generally hands over site areas in bits and pieces

According to India Ratings, funding shortfall may not be the only reason for languishing projects, but also delays in getting the appropriate approvals and clearances from various government agencies. While this has resulted in project deferrals and cost overruns, the same has further increased the stressed loans in the banking system.

A major concern which is affecting the road sector is shortage of quality manpower, apart from the raw material at time.



“The new Hybrid Annuity model should bring back private sector investments in the highway sector.”

D K Sen, Whole Time Director and Senior Executive Vice President (Infrastructure) Larsen & Toubro

Rishabh Sethi, Executive Director, SPML Infra Limited says, “We deal with the issues by having regular coordination with the clients, training to the operators, technicians, engineers and supervisors to create the skilled manpower, technical knowhow of the new equipment, safe operation and maintenance, fault diagnosis and troubleshooting, quality assurance and control, health, safety and environment protection, economics of the new technology adoptability and future up gradation.”

Conclusion

While the recovery of the highway sector is certainly on the cards, the pace of recovery is contingent upon the timely execution of policy measures and an economic milieu conducive to meet the immediate funding requirements of the sector. “If the government succeeds in getting the proposed US funding and finances from insurance and pension funds for the road development apart from their own budgets, the sector would again become an attraction for the private developers,” hopes Sethi.

“The need of the hour is to streamline the execution of the stalled infrastructure projects. This would not only help private developers to improve their cash flow but also revive lenders’ confidence in the sector,” concludes Chowdhury.

EPCWorld