IMPLICATIONS OF DRAFT PRUDENTIAL FRAMEWORK FOR INCOME RECOGNITION, ASSET CLASSIFICATION AND PROVISIONING PERTAINING TO ADVANCES ISSUED BY THE RBI ON HAM PROJECTS

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Published on Live Law

A lot has been spoken about the potential detrimental effects of RBI's draft prudential framework applicable to financing of project loans released on May 3, 2024 ("**Draft Guidelines**") on various sections of the economy. While the Draft Guidelines were issued to address the underlying risks associated with the financing of projects by providing an enabling framework for the regulated entities, almost all affected players were quick to react, and they did rather scathingly, in the process raising serious doubts over the efficacy of the Draft Guidelines. It is essential to capture the implications of the Draft Guidelines on HAM (Hybrid-Annuity Model) Projects and whether the outpouring of industry wide outcry is justified.

As a standard provisioning mandate, RBI has proposed that for all under development projects at various stages with DCCO (**Date of Commencement of Commercial Operations**), RE (**Regulated Entities** – banks and financial institutions) must provision for 5% of their respective funded outstandings against all existing as well as fresh exposures on a portfolio basis – this is a sharp increase from the existing 0.4% provisioning requirement. The Draft Guidelines allow for the reduction of the provisions to 2.5% and further down to 1% of the funded outstanding, if operations of the asset result in positive net operating cash flow that is sufficient to cover current repayment obligation to the lender(s), and the total long-term debt of the project has reduced by at least 20% from the outstanding at the time of achieving commissioning.

In addition to the above, RBI is also mulling moving land availability as a pre-sanction condition as opposed to a pre-disbursement condition, further limiting the moratorium period and restricting the DCCO extension. The combined effect of such measures could further delay financial closure for HAM based infrastructure projects. RBI has also proposed that the tenor of loan facility inclusive of the moratorium period, must not exceed 85% of the economic life of the project, thereby resulting in a mandatory tail period of 15% of a project's economic life.

In India, HAM based projects generally prescribe a 15-year concession period. As per the current language of the Guidelines, the developers of infrastructure projects will be forced to infuse further capital (experts estimate the increase to be in the vicinity of 7.5-10%) to align the cash flows with the amortization schedule of the projects. This may further thwart attempts of large-scale infrastructure projects to avail/explore refinancing opportunities.

HAM projects usually take about a year to experience stabilized cash flows. However, they have found traction and acceptance from the industry owing to their ability to offer

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comparatively more stable cash flow than their PPP cousins. This creates opportunities for leveraging the improved credit profile to reduce the cost of debt. However, the requirements of reduction of outstanding by at least 20% may take the sheen away from HAM projects. The revised tail period condition is expected to dent investment appetite amongst the players considering the longer gestation periods and considerable risks associated with such projects.

The only silver lining appears in form of the purported exclusion of InVITs from the applicability of the Guidelines. This may deepen the InVIT market as more and more operational assets would gravitate towards InvIT structure. RBI should adopt 'don't fix it if it's not broken' approach and consider the industry's reaction before rolling out the Guidelines.

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