A robust infrastructure is the fundamental need of a developing nation. India's infrastructure is developing; and coming out of the shadows of its arduous past. With a huge and diverse nation like India, the task of developing infrastructure is not an easy exercise. In the past few years, the government has set ambitious targets for the infrastructure sector, but funding has always been a major challenge.

As per CRISIL estimates, over the next five years, India's infrastructure needs funding of ₹43 trillion. Historically, the funding for infrastructure projects has been primarily done by the Centre and the States. As per World Bank estimates, in 2015 India's PPP investments declined for the 6th continuous year and reached a 10-year low. Correspondingly, in the revised estimates of the 12th five-year plan, the investment by the private sector in infrastructure increased to just 39% (as opposed to the estimates of 49%) from 37% in the 11th five-year plan.

Devendra Kumar Vyas, CEO, Srei Equipment Finance Ltd.

The task before the government now is to reduce the dependence of the infrastructure sector on state funding by developing alternative sources of funding.

The increasing stress in the banking system

The increasing amount of non-performing assets (NPAs) has currently affected the banks' potential funding to the infrastructure sector. From lax lending exercises to poor execution of infrastructure projects, there were a myriad of reasons for NPAs to keep piling up in the recent past. The stressed advances ratio for the scheduled commercial banks although marginally decreased from 12.3% in September 2016, still stood high at 12% in March 2017. The deployment of gross bank credit to infrastructure decreased by around 6 percent to fall to ₹9 lakh crores in March 2017, as compared to about ₹9.6 lakh crores in March 2016. However, in the recent past, we have witnessed a lot of positive steps to tackle the issue of stressed assets.

Recent steps taken to tackle the increasing stress

In lieu of the increasing stress assets, the government and RBI have taken a number of measures to mitigate the stress. Some of the steps taken are:

Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016

The debt recovery laws of the country like the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) 2002, Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), Recovery of Debt Due to Banks and Financial Institutions Act, 1993 (RDDBFI), and other schemes like corporate debt restructuring have been a topic of intense debate in the recent past in the wake of mounting stressed and non-performing assets (NPA's) in the financial sector, and the failure of these legislations in providing a credible debt recovery mechanism to banks and financial institutions. Between FY 2004 and FY 2013, cases of about ₹2.063 trillion came under SARFAESI Act, but recovery was made for only ₹0.635 trillion, underpinning the shortcoming of the Act.

To iron out the glitches in the existing laws, the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill, 2016, was passed last year. The aim of the Bill is to improve ease of doing business and facilitate investment for higher economic growth and development

Insolvency and Bankruptcy Code, 2016

The Insolvency and Bankruptcy Code, 2016 ('Code' or Bankruptcy Code) received Presidential consent on 28th May, 2016. The Code has been enacted in the midst of soaring NPAs. After issuance of the draft legislation, various changes were made incorporating recommendations by the Joint Parliamentary Committee (JPC) in April 2016, after which the Code was passed in Lok Sabha and by the Rajya Sabha. The approach towards passage of Bill should be applauded as it reflects the intent with which the Code is sought to be enforced and implemented.

The Code aims to bring about a change and improve ease of doing business in India, facilitate better & faster debt recovery process for maximizing asset value, facilitate hassle-free and time-bound closure of businesses, improve foreign investment and credit perspective; and facilitate investment for higher economic growth and development.

Ordinance in Banking Regulations Act

The government recently passed the ordinance for the Banking Regulations Act. With the help of this Act, the government has given more teeth to RBI to tackle the problems of stressed resolutions.

- ♦ With government's authorization, the RBI may direct banks to initiate insolvency against defaulters under bankruptcy code.
- ♦ RBI on its own, may issue direction to banks for resolving stressed assets.
- ♦ RBI can also appoint members of the committee it can form to advise banks on resolution of stressed assets.

Issues in Infrastructure Financing

Despite the unwavering efforts by the government to reduce the impediments, there continue to be a few bottlenecks which hamper growth. Global meltdowns and volatilities in the stock markets also reduce the confidence of foreign investors. Infrastructure companies are already over-leveraged and therefore, are finding it difficult to attract foreign investments.

The infrastructure projects require long periods to generate returns; and therefore, the asset liability mismatches (ALM) created due to the different timelines are also adding pressure on the banks. Sourcing funds with long-term maturities is a viable option to counter the effects of ALM.

Credit rating is low for the majority of companies in the infrastructure sector. Pension funds, Insurance companies and other big investors generally prefer to invest in companies/projects with ratings of AA and above. Even the special purpose vehicles (SPVs) which are created to alienate the projects from the parent companies are not able to garner great ratings due to their lack of age. To tackle this problem, in 2015, the RBI had introduced Partial Credit Enhancements (PCE) for corporate bonds and SPVs. The industry is collectively making efforts to educate itself on PCE to reduce the problems created by poor ratings and attract big investors.

Even seemingly minor issues have impacted the development of infrastructure financing like discrepancies in the rates of stamp duty. Debentures, for example, have a high stamp duty. In fact, the overall complexity of stamp duty discourages the development of a bond market. Government needs to take steps to address these grievances to make the debt market more attractive. For example, it can introduce uniformity in stamp duty across states with the introduction of a standard national rate with a maximum capping.

Alternative Funding Sources and Vehicles

The Debt Market – a lucrative option

At 17% of the GDP (in Jan, 2017), the Indian bond market is extremely underdeveloped when compared to US (115%), UK (114%), China (46%), Japan (68%) of the GDP. The Indian corporate bond market has been seeing unprecedented growth over the past few years. In 2016-17, the corporate bond market crossed the ₹7 lakh crore mark, a growth of around 43% over 2015-16. The growth in FY16 was a mere 6 percent, but it came on the back of 62% growth in FY15. So the past few years have seen a healthy growth in the Indian corporate bond market. The quality of these instruments too has been improving and the infrastructure sector needs to further leverage the growing debt market. The option of long-term maturity for bonds make them an attractive instrument for infrastructure financing.

Credit Enhancement Guarantee Fund

In the 2016 budget, the government had announced development of a Credit Enhancement Guarantee Fund. Recently, the government appointed India Infrastructure Finance Co. Ltd. to head the fund (with a seed capital of ₹1,500 crs). The fund can provide the assurance for upto ₹40,000 crores of infrastructure projects. This offers an additional assurance on part of the borrowers if they are to default on loans. The fund will also help in raising loans at reduced costs for the borrowers.

Masala Bonds

In external commercial borrowings, the main difficulty for corporates is that the issuing currency is not INR, which leads to the currency risks and the costs that come with it. Since masala bonds are issued in Indian National Rupee, it's the investors who bear the currency risks, helping the bond issuer to mitigate its own risk. In FY2016-17, more than ₹30,000 crores of masala bonds were issued.

Infrastructure Investment Trusts (InvITs)

The Infrastructure Investment Trusts (InvITs) are other vehicles for financing infrastructure. By pooling multiple projects under a single trust, infrastructure developers can monetize their assets by selling the cash flows of the pool to the investors. InvITs can have long-term maturities similar to that of government securities. Worldwide, InvITs are poised as high dividend paying instruments with stable cash flows over a long-term period.

Additional steps that can benefit the infra financing sector

The following 10 steps, if implemented, can benefit the infra financing sector:

- Defined timelines for clearances of issues and awarding of projects.
- Infrastructure needs long-term financing. It is, therefore, necessary to create a conducive environment for the same. A tax structure needs to be put in to encourage long-term investments from pension and insurance funds, which hold the ability to provide funds for projects with longer gestation periods. The raising of FDI ceiling for insurance can also help in procuring more funds.
- The government can work towards promoting green bonds by Asian Infrastructure Investment Bank and the New Development Bank for financing green energy infrastructure.
- Promoting Masala Bonds.
- Strengthening of local bodies to maximize the potential of municipal bonds.
- Providing tax breaks for infra bonds.
- The government also has to incentivize investing in infrastructure. It has to create robust project revival and exit mechanisms.
- There needs to be more specialized infra companies like the Sagarmala Development Company to bring in better project management of large infrastructure projects. SPVs for these special projects, too can help source from the capital markets.
- Develop and promote more infrastructure funds like National Investment and Infrastructure Fund.
- One advantage India has is that it sees relatively less impacts of external shocks; and currently, the government has liberalized FDI in many sectors. The government has to market these factors to bring in more investments.

Conclusion

In the last three years, the government has taken many steps to speed up infrastructure development. The rapidly growing Indian economy means the rising expectations of a better India replete with better infrastructure. At this point, the government has to look at alternative source of funding. Capital markets can save the day here. The Financial Stability and Development Council, chaired by the Hon'ble Finance Minister of India, can be the guiding light and play the role of the think tank for the nation's financial services industry and build trust amongst the financial sector. With efforts from all the stakeholders, we are sure to witness brighter times for India's Infrastructure.