Indian Road Sector

Monetisation of 75 projects through toll-operate-transfer route to fetch funding for NH execution; NHAI seems unlikely to meet the award and execution target for FY2017

(Image source: Shutterstock)

ICRA RESEARCH SERVICES

Contacts:

K Ravichandran
+91 44 4596 4301
ravichandran@icraindia.com

Shubham Jain
+91 124 4545 306
shubhamj@icraindia.com

Rajeshwar Burla
+91 40 4067 6527
rajeshwar.burla@icraindia.com

January 2017

WHAT'S INSIDE?

Summary Overview

In August 2016, the Cabinet Committee on Economic Affairs (CCEA) had authorised the National Highways Authority of India (NHAI) to monetise public funded National Highway (NH) projects which are operational and generating toll revenues for at least two years after the Commercial Operations Date (COD) through the Toll-Operate-Transfer (TOT) model. In the past, the toll collection and maintenance work was assigned to different entities viz. tolling agents and O&M contractors. Subsequently in 2009, to utilise the private sector's efficiencies in operating and tolling, the toll collection and maintenance works were integrated into one single contract resulting in the introduction of Operate, Maintain and Transfer (OMT) contracts. The OMT is, therefore, a combination of tolling and O&M contracts. Although OMT contracts have annual concession fee obligations to the NHAI (in few cases, O&M support may be required); the primary objective in case of OMT contracts is to outsource O&M activity to ensure timely maintenance and are typically for a shorter tenure ranging between 6-9 years. In order to create a framework for attracting long-term investments on the strength of future toll receivables, the TOT model has been introduced wherein the objective is to monetise the projects (longer tenure contracts ~30 years) so as to generate the corpus to meet the NHAI's funding requirement for new road infrastructure in unviable geographies.

Under this new TOT model, 75 operational NH projects totaling 4,376 km completed under public funding have been preliminarily identified for potential monetisation. Nearly 26 projects (35% of total) are on a BOT(Annuity) basis and remaining 65% are Engineering, Procurement and Construction (EPC) projects. For these 75 projects, the median vintage in terms of toll collection track record stood at 5.22 years. Of the portfolio, 25 projects (33%) are part of the Golden Quadrilateral (GQ) with high traffic density, where the average toll collection per day is at Rs. 1.6 million whereas for the non-GQ stretches it is Rs. 0.7 million per day. The total value of 75 projects proposed to be awarded through TOT route is estimated at Rs.356 billion. Assuming the average cost to the NHAI as Rs. 0.13 billion per km (for a four-lane project), the proceeds from monetisation through the TOT route can be used towards construction of around 2,700 km. The government intends to attract institutional investors including pension & insurance funds, sovereign funds, etc for this model.

The Government is yet to finalise some of the key aspects related to the TOT model viz. a) Bundling of projects and b) Eligibility criteria of bidders. Given the wide variation in toll collections, the attractiveness of certain stretches with long vintage and established traffic volumes – especially the ones along the GQ is much more when compared to the ones with less operational track record and poor toll collections. In this context, it makes sense to bundle the projects so that weaker projects are not left out and NHAI could also consider keeping floor and cap so that the bidding is not very aggressive in case of attractive stretches. Geographically diversified stretches are good for the NHAI so that weak and strong projects can be mixed. However, from the developer's perspective, they will be more interested in contiguous stretches, given the operational synergies/ scale benefits.

Key challenges in TOT model from bidder's perspective

Given that the concession period for TOT projects is expected to be 30 years with permissible debt upto 80% of concession fee, in the absence of longer tenure debt (beyond 15 years currently), it could be difficult to avail debt equivalent to 80% of concession fee or alternately projects with such high debt levels would require refinancing at a later stage. The TOT concessionaires will remain exposed to traffic risk; however availability of past traffic data will help in better forecasting. Another area of major concern for the bidders is the quality of the asset – for many EPC projects which are irregularly maintained in the past, the major maintenance requirement could be significantly higher once the TOT concessionaire takes over the project.

In terms of award and execution, the NHAI is expected to miss the target for FY2017 by a wide margin

The Ministry of Road Transport and Highways (MoRTH) planned to increase both the awards and the execution in FY2017 by 2.5 times from that of the FY 2016 levels. For the NHAI, the targets are steeper with a target execution of 8000 km (@21.92 km/day) and target awards at 15,000 km. Given that the execution during FY2016 was at around 5.44 km/day, the target for FY2017, @ 21.92km/day, is almost four times higher. ICRA in its research report dated May, 2016[1] opined that the target looks ambitious and is difficult to achieve. During 8M FY2017, 41 projects totaling 2598 km were awarded. The NHAI now intends to award a total of 6,615 km in FY2017 which is 44% of target awards. Although the pace of execution increased by 17% during 8M FY2017 to 5.82 km/day from 4.96 km/day, during 8M FY2016; it is just 27% of target execution of 21.92 km/day. Therefore, in terms of both award and execution, the NHAI is expected to miss the target by a wide margin. Nonetheless, the road sector has witnessed resurgence in recent quarters due to several policy initiatives, which is a credit positive.

Impact of demonetisation: NHAI's proposed compensation for toll revenue losses insufficient

Classifying the temporary suspension of toll collection post demonetisation as a political event under force majeure, the NHAI plans to provide compensation to the extent of 90% of interest cost and O&M expenses for the 24-day period. The compensation is only to the extent of the interest accrued on the principal amount of debt provided by senior lenders for financing the total project cost (or the NHAI-approved refinancing package as the case may be). It does not cover the debt repayment obligation.

ICRA believes that the proposed compensation mechanism based on O&M and interest costs, could lead to disputes with developers given the huge revenue loss for them. As per the NHAI's circular regarding compensation to BOT (Toll) concessionaires, this event has been classified as a political Force Majeure event. However, Clause 34.4 (a) also clearly states that if the aggregate financial effect exceeds the higher of Rs. 1 crore or 0.5% of net realisable fee in any accounting year, it comes under Clause 41 of the concession agreement, which is Change in Law.

Given that the revenue loss is greater than Rs. 1 crore in most of the BOT (Toll) projects and even in terms of the net realisable fee, it is around 6.6% (24/365*100), some of the developers want Clause 41 to be invoked in this case. Under this, the NHAI is obligated to place the concessionaire in the

---

[1] Titled *"Major maintenance reserve adequacy- a critical credit driver for BOT road projects"*.

same financial position as it would have enjoyed had there been no such change in law. In which case, the clause also provides for cash compensation for revenue loss in order to protect the net present value of the cash flows to the developers. Unlike annuity road projects, where the principal repayment is due on a semi-annual basis (in sync with semi-annuity payments from authority), a majority of the toll road projects have monthly debt-repayment frequencies. With only interest cost and O&M expenses getting compensated, the compensation, it seems inadequate from the debt servicing point of view, unless the project has DSRA or other cash reserves to fall back on.

Please contact ICRA to get a copy of this report

CORPORATE OFFICE
Building No. 8, 2nd Floor,
Tower A, DLF Cyber City, Phase II,
Gurgaon 122002
Ph: +91-124-4545300, 4545800
Fax; +91-124-4545350

REGISTERED OFFICE
1105, Kailash Building, 11th Floor,
26, Kasturba Gandhi Marg,
New Delhi – 110 001
Tel: +91-11-23357940-50
Fax: +91-11-23357014

CHENNAI
Mr. Jayanta Chatterjee
Mobile: 9845022459
5th Floor, Karumuttu Centre,
498 Anna Salai, Nandanam,
Chennai-600035.
Tel: +91-44-45964300
Fax: +91-44-24343663
E-mail: jayantac@icraindia.com

HYDERABAD
Mr. M.S.K. Aditya
Mobile: 9963253777
4A, 4th Floor, Shobhan,
6-3-927/A&B, Rajbhavan Road, Somajiguda
Hyderabad 500 082.
Tel: +91-40-40676500
Fax: +91-40- 40676510
E-mail: adityamsk@icraindia.com

MUMBAI
Mr. L. Shivakumar
Mobile: 9821086490
3rd Floor, Electric Mansion,
Appasaheb Marathe Marg, Prabhadevi,
Mumbai - 400 025
Ph : +91-22-30470000,
24331046/53/62/74/86/87
Fax : +91-22-2433 1390
E-mail: shivakumar@icraindia.com

KOLKATA
Ms. Vinita Baid
Mobile: 9007884229
A-10 & 11, 3rd Floor, FMC Fortuna,
234/ 3A, A.J.C. Bose Road,
Kolkata - 700020
Tel: +91-33-22876617/ 8839,
22800008, 22831411
Fax: +91-33-2287 0728
E-mail: vinita.baid@icraindia.com

PUNE
Mr. L. Shivakumar
Mobile: 9821086490
5A, 5th Floor, Symphony,
S. No. 210, CTS 3202,
Range Hills Road, Shivajinagar,
Pune-411 020
Tel : +91- 20- 25561194,
25560195/196,
Fax : +91- 20- 2553 9231
E-mail: shivakumar@icraindia.com

GURGAON
Mr. Vivek Mathur
Mobile: 9871221122
Building No. 8, 2nd Floor,
Tower A, DLF Cyber City, Phase II,
Gurgaon 122002
Ph: +91-124-4545300, 4545800
Fax; +91-124-4545350
E-mail: vivek@icraindia.com

AHMEDABAD
Mr. Animesh Bhabhalia
Mobile: 9824029432
907 & 908 Sakar -II, Ellisbridge,
Ahmedabad- 380006
Tel: +91-79-26585049/2008/5494,
Fax:+91-79- 2648 4924
E-mail: animesh@icraindia.com

BANGALORE
Mr. Jayanta Chatterjee
Mobile: 9845022459
'The Millenia', Tower B,
Unit No. 1004, 10th Floor,
Level 2, 12-14, 1 & 2, Murphy Road,
Bangalore - 560 008
Tel: +91-80-43326400,
Fax: +91-80-43326409
E-mail: jayantac@icraindia.com

ICRA Limited

CORPORATE OFFICE
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300; Fax: +91 124 4545350
Email: info@icraindia.com, Website: www.icra.in

REGISTERED OFFICE
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50; Fax: +91 11 23357014

Branches: **Mumbai**: Tel.: + (91 22) 24331046/53/62/74/86/87, Fax: + (91 22) 2433 1390 **Chennai**: Tel + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294, Fax + (91 44) 2434 3663 **Kolkata**: Tel + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008, Fax + (91 33) 2287 0728 **Bangalore**: Tel + (91 80) 2559 7401/4049 Fax + (91 80) 559 4065 **Ahmedabad**: Tel + (91 79) 2658 4924/5049/2008, Fax + (91 79) 2658 4924 **Hyderabad**: Tel +(91 40) 4067 6500, Fax + (91 40) 4067 6510 **Pune**: Tel + (91 20) 2552 0194/95/96, Fax + (91 20) 553 9231