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Infrastructure Build the new, save the old, find the funds

Building India's infrastructure assets remains an important area for the government. Road and rail networks in the country need to be built or upgraded. Moreover, power production still relies on coal, telecom companies are in distress, networks are patchy, airports are congested, and airlines are in trouble. To address these issues, the Indian government has set out a plan to spend US\$ 1.4 trillion on infrastructure in the next five years and achieve its ambitious target of making the country a US\$ 5 trillion economy. The report of the task force on the National Infrastructure Pipeline, released in December 2019, sets out a roadmap for the plan. It estimates that about 70 percent of the infrastructure spend should be in the following sectors – energy (US\$ 0.35 trillion), roads (US\$ 0.28 trillion), urban (US\$ 0.23 trillion), and railways (US\$ 0.19 trillion). The report also provides recommendations on changes required to sectoral policies, and reforms that need to be initiated by central and state governments. It suggests setting up a monitoring mechanism to ensure timely implementation of projects.

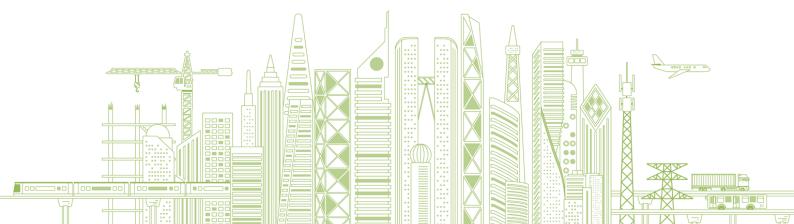
Hence, funding – public/private or Indian/foreign – is needed to build new projects and restart existing stressed ones. The only way to bring private/foreign investment in the country is to make the infrastructure sector remunerative for investors. Contracts and commitments should also be honoured. Governments (both central and state) should ensure timely payments for better financial planning; put in place tax principles, and steady and consistent policies; and focus on economic growth. There is a lot to do, but a clear path is required. Can we find such a path and take it? A brief discussion on it is given below.

Building the new

Many projects have been announced and are under different stages, ranging from conceptualisation to construction. The dedicated freight corridors aim to change the way logistics businesses run. Passenger transit is being redefined following the launch of bullet train, rapid urban transport networks, and a plan for 100 new airports. The Delhi-Mumbai Industrial corridor and similar industrial projects aim to use the 'Make in India' platform. These corridors, coupled with other large projects, are global in nature and involve substantial private participation. However, addressing structural issues by way of containing government spending, garnering private and foreign participation, and building world-class assets, is important. Regulatory provisions now allow external loans and foreign direct investment in infrastructure projects. Further, the option of registering as a foreign venture capital investor provides interesting solutions for debt funding. On the other hand, an Indian investor has multiple options to invest through debt and equity. These options involve various combinations of debt and equity or quasi-debt solutions to deliver an expected return.

While India has embarked on a path of substituting profit linked tax incentives with investment-linked tax incentives across the board with a view to achieving a simpler tax regime, the impact of tax incentives should be compared with the need for government funding. As an incentive, is there a case to remove taxes if the need for government funding is reduced? Does it make sense for an investor to look at projects from a target IRR standpoint over a project's life, and then navigate a combination of tax exemption and funding support to drive IRR?

Budgetary allocation suggests that the government's focus is on developing a robust network of roadways, railways, and airports as well as ensuring availability of power through the 'One Nation–One Grid' model. However, the government needs to extend non-fund based support in the form of giving land clearances, coordination between the central government and state government, an appropriate payment security mechanism, and faster dispute resolution. A higher focus on these could go a long way in accelerating infrastructure creation with the help of the private sector's participation.



Save the old - facilitate exit for stressed partners and monetise strong assets

Although new projects are being built, acknowledging that many old ones are distressed is important. Protecting these underperforming projects is also very important. Many of them are on sale through a strategic process, a one-time settlement with banks, or under insolvency and bankruptcy (IBC) process. As these transactions take a lot of time, any change in rules after the completion of the transactions has been a concern. The revising of concession agreements, power purchase agreements, or review of projects (granted by earlier governments) by a state government materially harms developers' interests. Further, buyers of such assets should be protected from any unpredictable shocks. The recent proposals that protect successful bidders who acquired assets through the process under the Insolvency Code is a welcome move. This move would go a long way in building investors' confidence in light to the challenges being faced while closing transactions. Moreover, monetising or valuing litigation, including that with government bodies, is a key issue that needs to be planned. Though not quite popular in India, 'third-party litigation funding' is being explored to monetise such debt claims to preserve working capital cycle and provide a valuation kicker to sellers.

Diligence processes do raise issues. Every buyer should take a note of these issues and make themselves aware of some potential pitfalls. Ensuring tax and regulatory structuring and compliance addresses financial and exit considerations. Although there is a case to not ensure regulatory coverage for private transactions (those executed outside the IBC process), there is a need for certainty on commercial aspects and the fact that these transactions save assets and jobs. The application of tax rules should have a holistic approach from an investor's perspective. As long as the structure is not tax evasive, recognition of some tax planning could be a fillip.

Find the funds

Investors are driven by returns and clarity of the underlying risks. These returns are described as IRR expectations or equity multiples. Either way, opportunities are assessed on the basis of return expectations and risks. National Highways Authority of India's ('NHAI') plan to park toll roads into Infrastructure Investment Trusts ('InvITs') is an interesting solution to the effective privatisation of some road assets using the toll-operatetransfer model. InvITs are driven by market parameters of existing assets and return expectations. Reverse bidding for power purchase agreements, which drive numbers to the bottom and frequently end up as distressed situations, have their merits. There is a need to find innovative solutions to fund the country's large infrastructure needs. The loan from Japanese International Cooperation Agency to fund bullet train demonstrates how affordable capital and technology can be used to deliver an aspirational infrastructure asset. International developers of infrastructure assets would prefer large projects over smaller pieces of a large project (being executed by different developers). More consultation is required to deliver this expectation. In any event, as discussed above, government participation in the form of funding support or tax reliefs needs to be balanced. The National Infrastructure and Investment Fund, established on 28 December 2015, has already tied up a capital of about US\$ 4 billion across four funds. Much of this fund still needs to be deployed. However, there are funds waiting in the wings for an innovative partnership to take off. This refers to a partnership between the government and foreign financial institutions/sovereign fund investors, to raise capital India needs for developing infrastructure.

Although there are challenges, some interesting solutions are emerging. The crux of the matter remains that more money is needed. Moreover, finding innovative solutions and a fine balance between many commercial and political considerations are keys to fulfilling our infrastructure development objectives.

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