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RESERVE BANK OF INDIA
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The Chairman and Managing Director/Chief Executive Officer
All Scheduled Commercial Banks
(Excluding Local Area Banks and Regional Rural Banks)

Dear Sir,

Flexible Structuring of Long Term Project Loans to Infrastructure and Core Industries

During the last decade, commercial banks have become the primary source of long term debt financing to projects in infrastructure and core industries. Infrastructure and core industries projects are characterised by long gestation periods and large capital investments. The long maturities of such project loans consist of the initial construction period and the economic life of the asset /underlying concession period (usually 25-30 years). In order to ensure stress free repayment of such long gestation loans, their repayment tenor should bear some correspondence to the period when cash flows are generated by the asset.

2. Banks have been representing to us that they are unable to provide such long tenor financing owing to asset-liability mismatch issues. To overcome the asset liability mismatch, they invariably restrict their finance to a maximum period of 12-15 years. After factoring in the initial construction period and repayment moratorium, the repayment of the bank loan is compressed to a shorter period of 10-12 years (with resultant higher loan instalments), which not only strains the viability of the project, but also constrains the ability of promoters to generate fresh equity out of internal generation for further investments. It might also lead to levying higher user charges in the case of infrastructure projects in order to ensure that greater cash flows are generated to service the loans. As a result of these factors, some of the long term projects have been experiencing stress in servicing the project loan.

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3. With a view to overcoming these problems, banks have requested that they may be allowed to fix longer amortisation period for loans to projects in infrastructure and core industries sectors, say 25 years, based on the economic life or concession period of the project, with periodic refinancing, say every 5 years. Banks have indicated that:

i. this would ensure long term viability of infrastructure/core industries sector projects by smoothening the cash flow stress in initial years;
ii. they would be able to extend finance to such projects without getting adversely impacted by asset-liability management (ALM) issues;
iii. the need for restructuring (owing to initial stressed cash flows due to 10-12 year loan tenors normally fixed) would be minimised, allowing banks to once again take up financing / refinancing of these project loans;
iv. they could shed or take up exposures at different stages of the life cycle of such projects depending on bank's single / group borrower or sectoral exposure limits;
v. with reduction of project risk and option of refinancing, ratings of such projects would undergo upward revision allowing lower capital requirement for banks as also access to corporate bond markets to project promoters at any stage based on such refinancing; etc.

4. It has also been suggested by banks that, the long tenor loans to infrastructure/core industries projects, say 25 years, could be structured as under:

i. The fundamental viability of the project would be established on the basis of all requisite financial and non-financial parameters, especially the acceptable level of interest coverage ratio (EBIDTA / Interest payout), indicating capacity to service the loan and ability to repay over the tenor of the loan;
ii. Allowing longer tenor amortisation of the loan (Amortisation Schedule), say 25 years (within the useful life / concession period of the project) with periodic refinancing (Refinancing Debt Facility) of balance debt, the tenor of which could be fixed at the time of each refinancing, within the overall amortisation period;
iii. This would mean that the bank, while assessing the viability of the project, would be allowed to accept the project as a viable project where the average debt service coverage ratio (DSCR) and other financial and non-financial parameters are acceptable over a longer amortisation period of say 25 years

(Amortisation Schedule), but provide funding (Initial Debt Facility) for only, say, 5 years with refinancing of balance debt being allowed by existing or new banks (Refinancing Debt Facility) or even through bonds; and

iv. The refinancing (Refinancing Debt Facility) after each of these 5 years would be of the reduced amounts determined as per the Original Amortisation Schedule.

5. Against this backdrop, in the Union Budget 2014-15, presented on July 10, 2014, the Hon'ble Finance Minster announced that:

> ***"131.*** *Long term financing for infrastructure has been a major constraint in encouraging larger private sector participation in this sector. On the asset side, banks will be encouraged to extend long term loans to infrastructure sector with flexible structuring to absorb potential adverse contingencies, sometimes known as the 5/25 structure. On the liability side, banks will be permitted to raise long term funds for lending to infrastructure sector with minimum regulatory pre-emption such as CRR, SLR and Priority Sector Lending (PSL)."*

6. The issues have been examined by the Reserve Bank of India (RBI). It is clarified that RBI has not prescribed any ceiling or floor on repayment period of loans, except in the case of special regulatory treatment for asset classification on restructuring[1]. Paragraph 1.3 of Master Circular – Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances, urges banks to ensure that while granting loans and advances, realistic repayment schedules are fixed on the basis of cash flows with borrowers as it would go a long way to facilitate prompt repayment by the borrowers and thus improve the record of recovery in advances. Further, in terms of circular DBOD.No.BP.BC.144/21.04.048-2000 dated February 29, 2000 on 'Income Recognition, Asset Classification, Provisioning and other related matters and Capital Adequacy Standards - Takeout Finance', banks can refinance their existing infrastructure project loans by entering into take-out financing agreements with any financial institution (FI) on a pre-determined basis. If there is no pre-determined agreement, a standard account in the books of a bank can still be taken over by other banks/FIs, subject to guidelines on 'Transfer of Borrowal Accounts

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[1] Paragraph 15.2.2 – Part B of Master Circular – 'Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances' dated July 1, 2014

from one Bank to Another' issued vide circular DBOD.No.BP.BC-104/21.04.048/2011-12 dated May 10, 2012.

7. Further, in partial modification to the above-mentioned circular dated February 29, 2000, banks were advised, vide circular DBOD.BP.BC.No.98/21.04.132/2013-14 dated February 26, 2014 on 'Framework for Revitalising Distressed Assets in the Economy - Refinancing of Project Loans, Sale of NPA and Other Regulatory Measures', that if they refinance any existing infrastructure and other project loans by way of take-out financing, even without a pre-determined agreement with other banks / FIs, and fix a longer repayment period, the same would not be considered as restructuring if the following conditions are satisfied:

i. Such loans should be 'standard' in the books of the existing banks, and should have not been restructured in the past;
ii. Such loans should be substantially taken over (more than 50% of the outstanding loan by value) from the existing financing banks/Financial institutions; and
iii. The repayment period should be fixed by taking into account the life cycle of the project and cash flows from the project.

8. In view of the above, RBI's instructions do not come in the way of banks' structuring long term project financing products, insofar as the prudential and regulatory framework is meticulously observed while structuring such products. However, as banks have certain misgivings that such refinancing of long term project loans may be construed as restructuring, and the estimated cash flows (balance debt in the form of bullet payment) at the end of each refinancing period may not be allowed to be counted in the appropriate maturity buckets for the purpose of ALM, the RBI clarifies that it would not have any objection to banks' financing of long term projects in infrastructure and core industries sector as suggested in paragraph 4 above, provided that:

i. Only term loans to infrastructure projects, as defined under the Harmonised Master List of Infrastructure of RBI, and projects in core industries sector, included in the Index of Eight Core Industries (base: 2004-05) published by the Ministry of Commerce and Industry, Government of India, (viz., coal, crude oil, natural gas, petroleum refinery products, fertilisers, steel (Alloy + Non Alloy), cement and electricity - some of these sectors such as fertilisers, electricity generation, distribution and transmission, etc. are also included in the Harmonised Master List of Infrastructure sub-sectors) - will qualify for such refinancing;

ii. At the time of initial appraisal of such projects, banks may fix an amortisation schedule (Original Amortisation Schedule) while ensuring that the cash flows from such projects and all necessary financial and non-financial parameters are robust even under stress scenarios;

iii. The tenor of the Amortisation Schedule should not be more than 80% (leaving a tail of 20%) of the initial concession period in case of infrastructure projects under public private partnership (PPP) model; or 80% of the initial economic life envisaged at the time of project appraisal for determining the user charges / tariff in case of non-PPP infrastructure projects; or 80% of the initial economic life envisaged at the time of project appraisal by Lenders Independent Engineer in the case of other core industries projects;

iv. The bank offering the Initial Debt Facility may sanction the loan for a medium term, say 5 to 7 years. This is to take care of initial construction period and also cover the period at least up to the date of commencement of commercial operations (DCCO) and revenue ramp up. The repayment(s) at the end of this period (equal in present value to the remaining residual payments corresponding to the Original Amortisation Schedule) could be structured as a bullet repayment, with the intent specified up front that it will be refinanced. That repayment may be taken up by the same lender or a set of new lenders, or combination of both, or by issue of corporate bond, as Refinancing Debt Facility, and such refinancing may repeat till the end of the Amortisation Schedule;

v. The repayment schedules of Initial Debt Facility should normally correspond to the Original Amortisation Schedule, unless there is an extension of DCCO. In that case, in terms of extant instructions contained in 'Master Circular – Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances' dated July 1, 2014, mere extension of DCCO would not be considered as restructuring subject to certain conditions, if the revised DCCO falls within the period of two years and one year from the original DCCO for infrastructure and non-infrastructure projects respectively. In such cases the consequential shift in repayment schedule by equal or shorter duration (including the start date and end date of revised repayment schedule) than the extension of DCCO would also not be considered as restructuring provided all other terms and conditions of the loan remain unchanged or are enhanced to compensate for the delay and the entire project debt amortisation is scheduled within 85%[2] of the initial economic life of the project as prescribed in paragraph 8 (iii) above;

vi. The Amortisation Schedule of a project loan may be modified once during the course of the loan (after DCCO) based on the actual performance of the project in comparison to the assumptions made during the financial closure without being treated as 'restructuring' provided:

a) The loan is a standard loan as on the date of change of Amortisation Schedule;

b) Net present value of the loan remains the same before and after the change in Amortisation Schedule; and

c) The entire outstanding debt amortisation is scheduled within 85%[3] of the economic life of the project as prescribed in paragraph 8 (iii) above;

vii. If the Initial Debt Facility or Refinancing Debt Facility becomes NPA at any stage, further refinancing should stop and the bank which holds the loan when it becomes NPA, would be required to recognise the loan as such and make necessary provisions as required under the extant regulations. Once the account comes out of NPA status, it will be eligible for refinancing in terms of these instructions;

viii. Banks may determine the pricing of the loans at each stage of sanction of the Initial Debt Facility or Refinancing Debt Facility, commensurate with the risk at each phase of the loan, and such pricing should not be below the Base Rate of the bank;

ix. Banks should secure their interest by way of proper documentation and security creation, etc.;

[2] A relaxation of only 5% of initial economic life is provided in case of delay in achieving DCCO from the 80% ceiling of amortisation of project debt prescribed in paragraph 8(iii). Banks may factor the same while determining Original Amortisation Schedule.

[3] Refer to Foot Note 2 above

x. Banks will be initially allowed to count the cash flows from periodic amortisations of loans as also the bullet repayment of the outstanding debt at the end of each refinancing period for their asset-liability management; however, with experience gained, banks will be required in due course to conduct behavioural studies of cash flows in such amortisation of loans and plot them accordingly in ALM statements;

xi. Banks should recognise from a risk management perspective that there will be a probability that the loan will not be refinanced by other banks, and should take this into account when estimating liquidity needs as well as stress scenarios. Further, unless the part or full refinancing by other banks is clearly identified, the cash flows from such refinancing should not be taken into account for computing liquidity ratios. Similarly, once committed, the refinancing bank should take into account such cash flows for computing their liquidity ratios; and

xii. Banks should have a Board approved policy for such financing.

9. The above structure will apply to new loans to infrastructure projects and core industries projects sanctioned after the date of this circular. Further, our instructions on ‘take-out finance’ (circular dated February 29, 2000) and ‘transfer of borrowal accounts’ (circular dated May 10, 2012) will cease to be applicable on any loan to infrastructure and core industries projects sanctioned under these instructions. RBI will review the instructions at periodic intervals.

Yours faithfully,

(Sudarshan Sen)
Chief General Manager