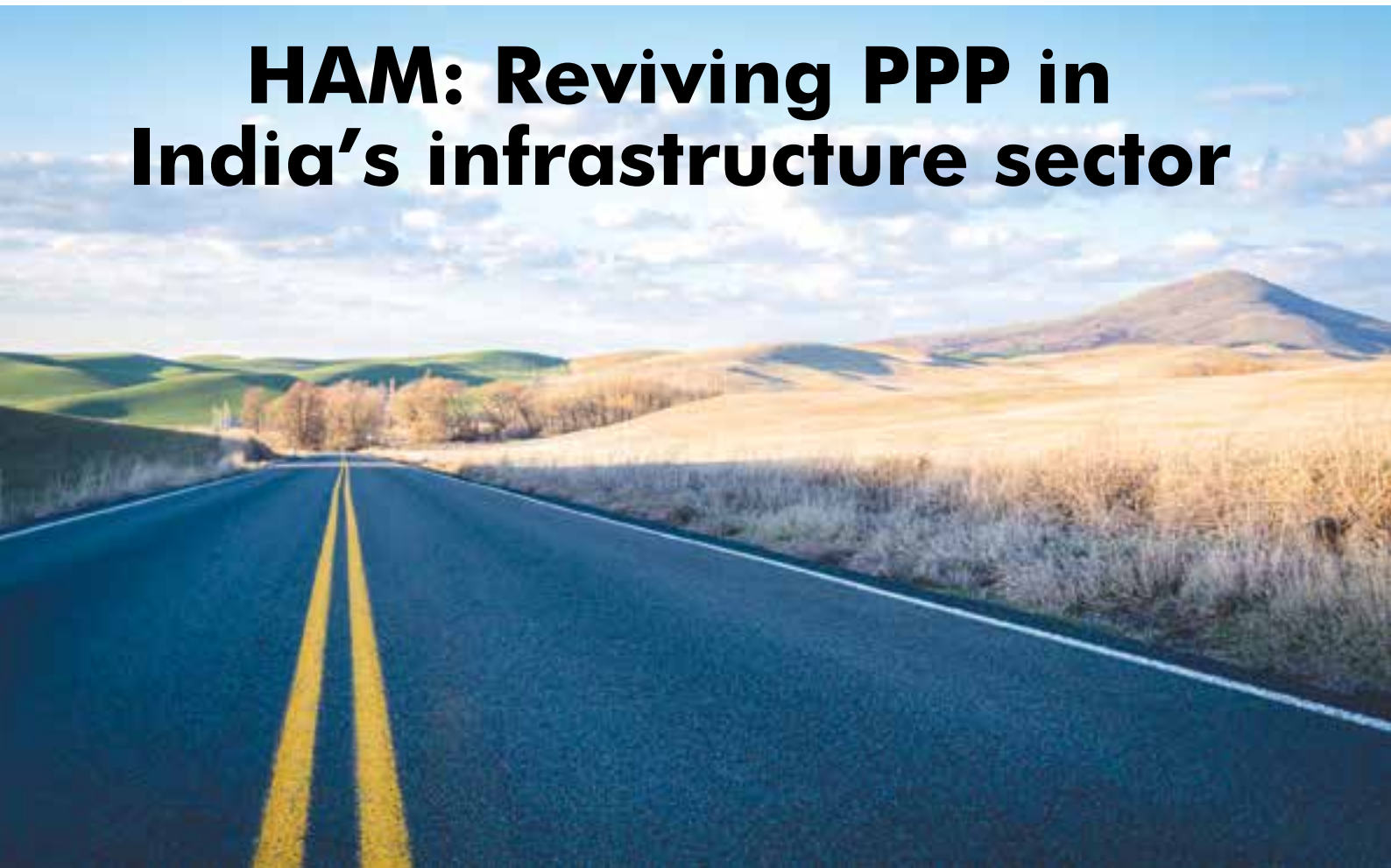


HAM: Reviving PPP in India's infrastructure sector



Currently, infrastructure development in India is taking place at an unprecedented rate. The country is investing heavily in infrastructure to uplift the living standards of millions of its citizens and support the industry. The infrastructure sector is a resource-intensive endeavor and involves huge amounts of investments. Arranging these huge funds for a single party is often a humongous task. Although the infrastructure projects are often for the public good, the government cannot keep on investing in the infrastructure projects and hope to generate revenue from the operation of the projects.

The Government of India implemented the public-private partnerships (PPPs) to finance infrastructure projects in the country; however, the program didn't meet the expected amount of success over sustained period after initial enthusiastic bids turned sour. There were fewer investors that came forward to participate in the PPP model with the government. Infrastructure financing is a difficult choice for most investors as the projects are affected by several internal and external factors. There are long gestation periods and high sunk costs. Various socio-economic, technical, political, and environmental factors

have a direct or indirect impact on the projects. These factors present significant challenges against the success of these projects. Due to a huge number of non-performing assets, banks are often reluctant to finance these projects.

To address the issues prevailing in infrastructure financing, the Government of India introduced the Hybrid Annuity Model (HAM). The HAM model is a combination of the EPC (Engineering Procurement and Construction) and the Annuity models for project finance. The model is being implemented by the Ministry of Road Transport and Highways (MoRTH) and has met with a decent amount of success so far due to sharing of capex during construction and eliminating traffic risks during operation.

HYBRID ANNUITY MODEL

As mentioned previously, the HAM model combines the elements of EPC and Annuity. In the EPC model of project finance, the government provides a private player with land and part of the CAPEX (to the extent of 40%) linked to completion of construction and the private player merely constructs the project and maintains it during balance Concession Period. Upon completion, the project is handed over by

the owner (in this case, NHAI or MoRTH) to an operator and generate revenue. While this is a simple straightforward model, most of the time, the government is unable to raise enough funds to finance the entire project or it considers it less significant to invest its money in a venture that could be funded from other means.

The BOT model under that PPP is slightly more complicated. The government's role in the project is limited to providing land acquisition and regulatory clearances for the project. Other tasks like funding and construction of the projects are totally the private party's responsibility. Upon completion, the private party operates and maintains the project till the concession period and hands it over to the government as the period ends. The private party generates revenue from the operations of the infrastructure asset or through the annuity paid by the government. Due to various underlying reasons, the BOT model rather failed in the Indian infrastructure sector as the private parties found it too risky to enter.

The HAM model involves payments by NHAI/MoRTH to the extent of 40% during construction with balance 60% paid as annuities along with indexed escalation and benchmarked interest. As the Government of India provides 40% of the project funding during construction, Concessionaire is responsible for raising balance 60% amount. The funding released by the government is done in five stages of the project construction. The private parties can raise their funds through debt, equity, or infrastructure

bonds. The private parties don't generate revenue through the operation of the asset. They recover their investment through the annuity paid by the government.

REASONS FOR THE SUCCESS OF HAM

The success of HAM is due to the provision of shared risk between the government and the private parties. In the EPC model, the majority of the risk burden fell on the government's shoulders while in BOT the private player had to bear the entire risk. In the HAM, besides providing regulatory support, the government also provides 40% of the finance. The private parties have to bring only 60% of the finance and recover their investment from tolling/annuity or both. Therefore, in case the demand forecast gets wrong, the private party is not at risk. Since the government is sharing the risk and putting in 40% of the capital, it is easier for the private parties to raise funds for the project. This way, the HAM provides a better financial mechanism for infrastructure finance.

Infrastructure finance is a complicated process. New models for project finance keep evolving. The Hybrid Annuity Model is the latest evolution in project finance. The PPP in the infrastructure sector has seen a new spark with this model. In the first six years of its existence, the model has helped India develop several crucial roads and highways. The success of this model is yet to be seen in other sectors; however, HAM gives the hope of providing a stable project finance model for the long term.



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