HIGHWAY TO UNCERTAINTY

Slippery road for hybrid annuity

BUMPS AHEAD. National highway construction hits a slow patch as funds go scarce and the hybrid annuity model falters

Rishi Ranjan Kala

From 34 km per day in FY24, the pace of national highway construction is expected to slow to 31 km per day. Credit rating agency CareEdge Ratings expects the execution pace to decline by 7-10 per cent year-on-year — from 12,350 km in FY24 to about 11,500 km in FY25.

Among other factors, the blame is being laid on the influx of mid-level developers with moderate credit profiles, especially after March 2020. The drastically expanded pool of bidders led to lower bids, but heightened the execution risks, including funding hurdles and other delays, analysts say. To make matters worse, projects under the hybrid annuity model (HAM) — a public-private partnership (PPP) model that combines engineering, procurement, and construction (EPC) and build, operate, transfer (BOT) models — haven't taken off as anticipated.

Maulesh Desai, Director, CareEdge Ratings, says other key challenges facing the roads sector include land acquisition hurdles and delays in the 'appointed date' — namely the handover of the contract letter to the successful bidder, enabling commencement of work.

SPEED LIMIT. From 12,350 km in FY24, national highway construction is projected to dip to about 11,500 km in FY25 SPECIAL ARRANGEMENT

IN FITS AND STARTS

Of the ₹1.5-lakh-crore HAM projects awarded after March 2020, nearly one-third are delayed by 4-6 months beyond the three-month grace period. Their aggregate 'bid project cost' (BPC) — the lowest lifecycle cost of the project, which includes construction, operation and maintenance — is ₹50,000 crore. The developers have applied for or received an extension for a similar or longer period, CareEdge says.

Notably, another significant chunk of HAM projects are awaiting an 'appointed date' for more than a year; their aggregate BPC is around ₹40,000 crore, as of April 1, 2024, as compared to ₹14,500 crore, as of June 30, 2023, the rating agency says. HAM projects for 2,200-plus km of national highways remain non-starters even a year after they were awarded.

Daleep Thusu, Senior Vice President of infrastructure consultancy Rudrabhishek Enterprises, says that while HAM was seen effective until March 2020, it has since fallen short, likely due to pandemic-related disruptions.

"Delays in project completion, cost escalations, and revenue uncertainties may have affected the attractiveness of the model [HAM] for private developers," he surmises. Moreover, the government's budgetary constraints and shift in focus to economic recovery may have reduced the outlay for infrastructure projects, thereby impacting HAM projects, he says.

REGULATORY CLARITY

InCoBAN, an infra-construction industry improvement ecosystem, observes that since March 2020 competition intensified in the roads sector with the inclusion of mid-sized sponsors of moderate credit standing, leading to execution risks, delays and funding scarcity. "Moreover, unexpected events such as Covid-19, post-bidding commodity price hikes, prolonged monsoons, and stringent debt terms have exacerbated the delays," says InCoBAN co-founder Abhilasha Panwar.

To remedy this, Panwar suggests stepping up project supervision, alongside exploring alternative funding sources such as multilateral organisations. "Simplifying approval processes, addressing regulatory hurdles, and nurturing collaboration among stakeholders can enable seamless implementation," she adds.

Echoing this, Thusu stresses the need for a concerted effort by government agencies, developers, financiers, and other stakeholders to expedite HAM projects. "It calls for removing regulatory bottlenecks, enhancing preparedness, collaboration, embracing technology and innovation, skills development, and a conducive policy environment," he says.

Panwar points out that clarity in regulatory guidelines not only fosters private sector participation but also encourages engagement in HAM initiatives.

PROJECT FINANCE WORRIES

The Reserve Bank of India's recent draft guidelines on project financing have added another layer of worry for embattled construction companies, which are anxious about the implications for under-construction infrastructure projects.

Rajashree Murkute, a senior director at CareEdge Ratings, says the draft guidelines hold out challenges for both under-construction and operational infrastructure projects. "A mandatory tail-period accounting for 15 per cent of a project's economic life will restrict the ability of infrastructure projects to secure additional top-up loans. CareEdge Ratings estimates that this will necessitate an 8-10 per cent increase in equity requirements for HAM-based road projects to align the loan tenure with 85 per cent of the economic life for concessions lasting 15 years," she explains.

Defining a specific credit event and implementing a resolution plan in a time-bound manner call for increased monitoring and timely reviews from all stakeholders, she adds.

Infrastructure projects, being capital-intensive, are sensitive to changes in interest rates. Consequently, a significant rise in provisioning requirements, from 0.4 per cent to 5 per cent, during the construction phase is likely to diminish the bidding appetite of developers in the medium term, she cautions.