FINANCIAL CHALLENGES AND OPTIONS IN COMPLIANCE OF NEW ENVIRONMENTAL NORMS

Naveen Kumar

Executive Director (Projects)

Power Finance Corporation Ltd.

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CATEGORY OF THERMAL POWER PLANTS
(FOR ENVIRONMENTAL UP-GRADATION)

- Plants yet to be constructed and considered for financial support by lenders.
- Plants already under operation where retrofit is to be done.
- Plants for which PPAs already exist (under CERC tariff regulations and tariff based bidding guidelines).
- Plants for which PPA is yet to be executed.

FINANCIAL CHALLENGES

- Non-availability of financial returns from the environment up-gradation projects shall make the project unviable for obvious reasons

- Increase in cost of environmental up-gradation projects

- Project cost may increase due to:

  - Delay in project implementation (delay in achievement of financial closure, delay in mobilizing equity by the borrower, delay in award of major contracts, delay in supplies/erection activities, delay in availability of shut down of the units
  - Increase in Interest rates/increase in IDC

- If the project cost increases, tariff also increases, IRR is not much affected if the increased cost is pass through in the tariff (Regulator to decide)

- If project cost increase is not pass through fully/partly in the tariff (due to regulatory interventions), then project viability may be adversely affected (IRR, DCSR etc. shall be below the limits acceptable to the lenders)

FINANCIAL CHALLENGES…CONTD.

- Increase in Interest rate shall result in increase in project cost/tariff with a little impact on DSCR. If Tariff is pass through then there is no issue. If PPA is not there and commensurate tariff is not available and/or power sale is difficult, it will financially strain the borrower(Supplier) and hence a concern.

- Lenders would be more comfortable with D/E ratio of 70:30 (considering the asset coverage requirements, impact on tariff, ensuring appreciable stake of the borrower in the project).

- Under certain situations D/E ratio of 75:25, 70:5:25, 70:10:20 may be accepted for IPPs. For state sector projects, D/E of 80:20 and sometimes even higher D/E ratio is also acceptable.

- For taking deviations from D/E ratio of 70:30, certain criteria are to be fulfilled such as promoters' experience in certain specific type/size of projects, integrated rating assigned by PFC, DSCR for the project, assured fuel supply etc. as per policy of PFC.

FINANCIAL CHALLENGES…CONTD.
(IMPACT OF DELAY IN EQUITY MOBILIZATION)

- **As equity component increases due to cost overruns etc., delay in mobilizing additional proportionate equity (by the project authorities/borrowers) shall delay the loan disbursals by the lenders, leading to further cost increase due to increased IDC**

- ✓ **The failure to bring the required equity may lead to stoppage of disbursal by the lenders and the project loan account may become sub-standard in future.**

- ✓ **The revival of the project may become a complex phenomenon due to different views taken by different lenders (in case of consortium financing).**

- ✓ **It may lead to a situation where, lenders may be required to consider options such as supporting the unsustainable debt (part of the project cost increase not approved by the regulators), the part of the equity not mobilized by the borrower etc viz resorting to taking hair cut etc.**

FINANCIAL CHALLENGES…CONTD.
(IMPACT OF DELAY IN EQUITY MOBILIZATION)

- **Unusually higher D/E ratio will result in lower tariff & shall adversely affect the DSCR and may not be acceptable as per the lenders' requirements**

OPTIONS FOR THE LENDERS (IF ANY) FOR SUPPORTING ENVIRONMENT UP-GRADATION PROJECTS ?

- Under what situations lenders could support such environmental up-gradation projects?

- **Policy relaxations by Lenders:** Adopting relaxed norms for funding such projects e.g. "in case of environmental up-gradation projects the Project financial/economic IRR may not be insisted upon"

- **Government Support**
  - ✓ Subvention from Govt**./**Viability gap funding/ Budget allocations
  - ✓ Interest subsidy by Govt
  - ✓ Deduction from Central Plan Assistance for repayments to lenders for state sector projects in the event of delay/default in such repayment.

OPTIONS FOR THE LENDERS IF ANY FOR SUPPORTING ENVIRONMENT UP-GRADATION PROJECTS ?

- **Viability Gap Funding is to make projects that are economically viable over the long term, commercially viable for investors**
- **Viability gap funding can take various forms, including capital grant, O&M support grants or interest subsidy.**
- **The gap between the revenues needed to make a project commercially viable (as per requirement of lenders) and the revenues likely to be generated through tariffs (as per requirement of investors) is to be bridged up through suitable mechanisms (viz. compensatory tariff) for projects awarded based on tariff based bidding**
- **Support for VGF may be provided from the government's budgetary allocation.**
- **To make provision for release of funds from National Clean Energy Fund (NCEF) and Power Sector Development Fund (PSDF) as suggested in the base paper of CEA.**


Thank
You!