Banks for 1–2% project finance provisioning

RBI proposed 5%; industry sees short-term pain

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Commercial banks are planning to write to the Reserve Bank of India (RBI), seeking a lower provision rate of 1-2 per cent as compared to the 5 per cent proposed in the recent draft norms on project finance. These draft norms propose to increase standard asset provision to 5 per cent, even for existing loans, from 0.4 per cent currently.

Such an increase in provisioning requirements could push the financing cost of projects, potentially rendering them unviable, argue bankers and experts. According to industry executives, lenders would suggest a 1 per cent standard asset provision for government or public sector projects, given the lower risk involved. For other projects, they would propose a 2 per cent provision.

The RBI recently released draft norms on the 'Prudential Framework for Income Recognition, Asset Classification and Provisioning pertaining to Advances — Projects Under Implementation'. These guidelines propose a phased 5 per cent standard asset provision during the construction phase.

A senior banker from a large public sector bank expressed concerns, saying: "For existing proposals, which are under construction and for which financing has already happened, if the provisioning is increased to 5 per cent, the economics of the project could be doubtful. One does not know if the project will still be viable."

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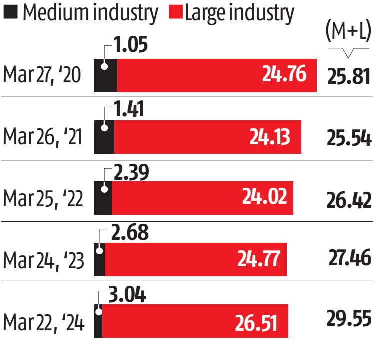
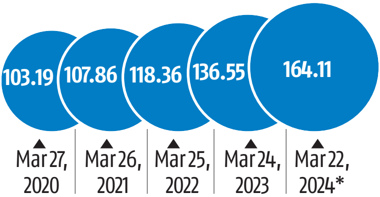
A LOOK AT EXPOSURE

Gross bank credit (in ₹ trillion)



Non-food credit (in ₹ trillion)



* Includes the merger of HDFC with HDFC Bank
Source: RBI

retail outlets from 5.1 million currently to 6 million over the next four to five years to drive this growth. A good monsoon and the re-injection of money after the formation of a new government will drive up private consumption and benefit consumer companies, he said.

Homegrown FMCG player Dabur India, which recorded a volume growth of 5.5 per cent in FY24, too is planning to stay focussed on volumes this financial year. "If we have to grow, volume growth is mandatory. We have taken a target of mid-to-high single digit volume growth, for which we need to increase our penetration. With 80 per cent penetration, we are already present in eight out of 10 households. If we want our entire portfolio to every house, volume growth is something we have to do without any compromises," said Mohit Malhotra, chief executive officer at Dabur India, during a call with investors after the Q4 results.

Malhotra told investors that Dabur's gross margin in mid-term to long-term will grow, but not to the extent it did in the previous year. That's because the company wants to increase its media spend.

Banks...

The official further said the sudden increase in provision to 5 per cent of the loan amount could "threaten the viability of existing cases", which have been assessed based on certain presumptions.

Bankers plan to request the Indian Banks' Association (IBA) to ask all lenders to conduct an impact assessment on their current portfolio and future projects. "When we meet the RBI, we should be able to present before it the real picture of the expected impact on us (due to the proposed increase in provisioning)," said the executive.

The executive suggested different treatment for government-owned entities or the public sector due to the implied sovereign backing. In such cases, the provisioning could be 1 per cent. For others, it could be 2 per cent. If a project is facing delays, the provisioning could be increased.

Banks acknowledge that some lenders may be offering rates for infrastructure projects by linking such loans to short-term rates like the repo rate. However, if that were the case, the RBI would have mandated linking project loans to longer-term rates like the marginal cost of fund-based lending (MCLR), rather than imposing blanket provision requirements.

Shanti Lal Jain, managing director and chief executive officer of Indian Bank, said: "Your balance sheet should be strong enough to take that kind of a risk... These are draft guidelines, so we will discuss them within the bank and the IBA and will give our request to the RBI to consider it." He stressed that Indian Bank would be least impacted as 63 per cent of its loan book is towards retail, MSME, and agriculture.

One reason for the sharp increase in provision norms is the rise in non-performing assets (NPAs) in the past decade, primarily due to many infrastructure loans turning bad. Gross NPAs hit 11.8 per cent of gross advances by March 2018, but have fallen over the past five years to 3.2 per cent as of September 2023.

Bankers claim to have learned from past mistakes, with loans going bad due to issues concerning environmental clearance, land acquisition, and others. "Now, no bank disburses unless a minimum of 90 per cent of land is acquired, and all permissions are in place before disbursements," said another banker.

Infra sector: Analysts see short-term pain

Rating industry experts and infra sector representatives predict short-term pain but believe the move is positive from a longer-term perspective.

Rajashree Murkute, senior director at CareEdge Ratings, said: "The draft guidelines for project financing proposed by the RBI, if implemented, are expected to present funding challenges for both under-construction and operational infrastructure projects."

The rating agency said the change in provisioning standards will directly impact the cost of debt, potentially dampening the bidding appetite from infrastructure developers in the medium term.

"Projects with stable cash flows, such as road annuities, transmission, and commercial real estate, typically see an improvement in credit profile within one year of establishing a payment track record from the counterparty. Therefore, the mandate to reduce debt by 20 per cent to lower provisioning could delay the realisation of interest rate benefits for such operational projects, despite an enhanced credit profile," said Murkute.

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 said. It will necessitate an 8-10 per cent increase in equity requirements for the hybrid-annuity model (HAM)-based road projects to align the loan tenure with 85 per cent of the economic life for concessions lasting 15 years, noted Murkute.

ICRA, too, echoed concerns regarding HAM road projects of National Highways Authority of India (NHAI). Vinay Kumar G, vice-president and sector head-corporate ratings, ICRA, highlighted practical challenges in implementing the proposed RBI regulations. "For a HAM road project of NHAI, the annuity becomes due for payment after 180 days of COD (commercial operations date), and the authority (NHAI) has 15 days for making the annuity payment as per the concession agreement. To address these timelines, HAM project sanctions generally have seven months (or higher) repayment moratorium from the COD date which provides a cushion of more than one month in case of administrative delays in annuity receipt, if any. However, the proposed RBI regulations will have practical challenges in implementing as the maximum moratorium period allowed is six months, thereby providing no headroom in case of delays in annuity receipt."

(With inputs from Dhruvaksh Saha, Shreya Jai & Abhijit Lele)

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