India Infrastructure Finance Company Limited
IIFCL

IIFCL INFRA NEWSLETTER

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Our Vision

"Provide innovative financing solutions to promote and develop world class infrastructure in India"

Our Mission

"To adopt best practices in financing infrastructure and develop core competencies in facilitating infrastructure development; Develop a team of highly engaged employees to deliver services in a professional manner and to the satisfaction of all stakeholders"

From the Chairman's Desk

The global economic crisis has led to further deterioration in economic outlook for almost all economies. According to International Monetary Fund, world growth is projected to fall between 0.5–1%, the lowest since World War II. The advanced economies viz., USA, Europe and Japan are all in recession. In developed economies, the financial markets are expected to remain strained, as policy for restructuring financial institutions and resolving losses gather pace. In emerging economies, financial conditions are expected to remain under stress, particularly, for corporate sectors. Helped by the expansionary fiscal and monetary policies, the global economy is expected to stage a gradual recovery in 2010. However, the economic outlook continues to remain uncertain and the timing and pace of recovery is dependent upon the strength of policy actions. The G-20 nations have pledged concerted action including extending regulation and oversight to all financial institutions and regulating credit rating agencies. A common approach to cleaning the toxic assets has been agreed upon and they have pledged to resist protectionism. Hopefully, the policy actions by governments across the world will yield the desired results.

In the Indian context, in response to the crisis, RBI injected massive liquidity into the system. The actual/potential liquidity was augmented by as much as Rs4,62,000 crore. Policy rates were cut in a number of moves CRR was reduced from 9% to 5%; SLR was cut from 25% to 24% and the Repo rate was brought down from 9% to 5%. The focus of monetary policy action shifted from fighting inflation to providing liquidity which in turn may help in promoting growth. Thus, the economy had to adjust to a contractionary policy till August 2008 which is being countered by way of an expansionary policy since October 2008. Further monetary easing has been made by the RBI in its recently announced Annual Policy 2009-10. The repo rate has been brought down to 4.75% and the reverse repo to 3.25%

The impact on the real sector was straight forward. The slump in international demand led to steep decline in exports and foreign trade. Growth in exports started declining from October and imports from November 2008. Industrial production has weakened and it dipped by 0.5% in January 2009 and in February 2009 further contracted by 1.2%. During the period April 2008 - February 2009, industrial production grew by 2.8% on year-on-year basis compared to 8.8% during the corresponding period in 2007-08. Although there are signs of revival in some sectors like cement, steel, and automobiles, the overall growth for the year is expected to be modest.

For the infrastructure sector, the constraints have only exacerbated. Till September 2008 as the inflationary pressures were being curbed, rate of interest headed northwards and touched as high as 14-15%. At such high interest rates, infrastructure projects become unviable and this lead to a slowdown in the number of projects. Thereafter, as the policy rates were eased to sustain growth, the risk perception amongst banks got heightened. Resultantly, the development of new projects has become subdued. In the road sector, as per NHAI data for 31st March 2009, of the total length of 33,097 KMs under the National Highways Development Programme(NHDP), 11,037 KMs have been four-laned, while 6,175 KMs are under implementation. The balance length which is to be awarded is 15,731 KMs. Land acquisition issues continue to pose a major constraint. Besides, issues like shifting of utilities, availability of Right of Way (RoW), obtaining environmental and other clearances and contractor capacity need to be addressed. In the power sector, the demand drivers continue to remain robust and number of private players have entered the sector, particularly, the generation segment. Power generation capacity has gone up from 1,24,287 MW in 2005-06 to 1,43,061 MW in 2007-08. The current generation capacity is 1,47,965 MW while 78,700 MW capacity addition has been targeted during 11th plan. During 2008-09, as against target of capacity addition of 11,000 MW, only 3,454 MW is estimated to come about according to the Central Electricity Authority. This is attributed to delays in site clearances, delays on the part of equipment manufacturers and fuel linkages. While projects which have achieved financial closure may not be affected due to the global *crisis, the impact on the transmission and distribution segments may not be much in view of the low private participation. There is minimal offtake risk considering that the power shortage is chronic. Some of the power projects also benefit from the guaranteed fixed return on capital, while the tariff regime provides for most costs to "pass through". However, in the case of UMPPs, there could be fuel supply and price risks on imported coal. Domestic power equipment capacity has not kept pace with demand although some of the international companies have expanded their capacity in India. In the case of airports, the rebuilding and modernization of the existing airports is progressing. With the decline in passenger traffic due to the economic slow down, the dependence non- airport revenue could increase. Passenger traffic during the period April- January 2009 fell by 6.3% compared to corresponding period in 2007-08, while the growth in cargo was 0.4%.*

In the wake of the economic slow down, the infrastructure sector presents a mixed picture. The progress of the projects under implementation has continued, while financing of new green-field projects at the current juncture appear challenging. However, there is a critical need to address issues like delays in land acquisition, provision of RoW and putting in place appropriate regulatory framework for each sector.

The real challenge lies in stimulating the infrastructure sector. At present, public sector banks are the main providers of finance to infrastructure projects. Typically, infrastructure loans are for 10 years and above. However, 81% of the banks' deposits are in the less than 5 year category. This implies asset-liability mismatch for banks and banks run the risk of financing long term assets with short term liabilities. To mitigate the situation, scheme of refinance by IIFCL has been evolved. Under the scheme, refinance would be provided to banks for new commercially viable projects in the roads and port sector where bids have been submitted on or after 31st January 2009 . IIFCL will provide refinance upto 60% of the loans provided by the banks to these infrastructure projects and the interest rate for such refinance would be 7.85%. Banks will not charge more than 2.5% over and above the rate of refinance. IIFCL has already raised Rs10,000 crore till 31st March 2009 by way of tax free bonds to provide refinance to banks. The refinance from IIFCL could supplement the resources available with banks to finance infrastructure projects. Once bank lending rates start easing, the interest of private sector players in bidding for new projects could revive.

What is required at the current juncture is accelerating the pace of infrastructure development. The emerging trends indicate that the outlook for the economy is mixed and RBI has projected a GDP growth of 6% for the year for 2009-2010. No doubt, there will be pains of short term adjustment. But once the global economy starts showing signs of recovery, India can rebound much faster.

S S Kohli
Chairman & Managing Director

AIRPORT INFRASTRUCTURE

Civil Aviation forms a crucial infrastructure segment in boosting trade and commerce, as well as, in enhancing overall international competitiveness and connectivity. India currently has 127 airports, including 16 international airports, 8 customs declared airports, 79 domestic airports, and 24 civil enclaves at the defence airfields, all of which are being managed by Airports Authority of India (AAI). Traditionally, airport development in the country has been in the public sector. However, the amendment to AAI Act and Aircraft Rules in 2004, has enabled private sector investments. 100% Foreign Direct Investment (FDI) is allowed in setting up of greenfield airports.

Growth of the Indian economy over the past few years has led to an interesting growth trend in the civil aviation industry also. Traffic at Indian airports has grown in all three segments viz., passenger, aircraft movement, and freight. The estimated total passenger throughput for all airports in India has grown from 39.03 million in 1999-2000 to 116.87 million in 2007-08. While the international passenger segment has witnessed a CAGR of 14%, the domestic passenger segment has registered a growth of 22% during this period.

With adoption of open sky policy for cargo, there has been a significant growth in cargo traffic. Cargo traffic handled at

airports has increased from 7,97,400 tonnes in 1999-2000 to 17,13,960 tonnes in 2007-08. During the year 2007-08, air cargo traffic grew by 10.5% over the previous year. At present, India contributes to over 1% of world air cargo traffic.

Developments in the aviation sector during this time period have been in line with macroeconomic growth, liberalization, and removal of policy barriers. The surge in the number of airlines, a consequence of the government's open sky policy and route expansion by airline companies, requires the airports to cope with growing infrastructure requirements, in terms of both capacity and standards. Almost all the airports in India face bottlenecks in terms of an acute shortage of parking space, terminal congestion, inadequate air traffic control systems, lack of communication and navigational aids, and low passenger amenities. Inadequate cargo handling procedures at airports also result in delays in transit from one terminal to another.

The airport sector has attracted considerable private interest. According to the 11th Plan projections, of the total investment requirement of Rs30,968 crore, as much as 70% (Rs21630 crore) is envisaged by way of private investment. The PPP route has progressively gained importance and is being used either for modernization or construction of airports or only for city-side development at airports. While the Cochin Airport was the only privately managed airport till the mid 2000s, there are now four more privately managed international airports in India viz., Delhi, Mumbai, and the two greenfield airports of Hyderabad, and Bangalore. More Greenfield airports at Goa, Navi Mumbai, Pune, Greater Noida and Kannur are being considered for development. The government has further identified 35 non-metro airports for development, involving the setting up of terminal buildings, car parks, and cargo and other airside facilities. The development of these airports would be taken up in three phases and the project model would be that all aeronautical services will be handled by the AAI, while PPP mode would be adopted for the development of non-aeronautical activities at the city-side of these airports.

Further, proposal for establishment of merchant airports is also being examined. The infrastructure in the merchant airports is completely developed by the private sector, while the government will be providing safety and security at these airports. Setting up of dedicated cargo airports which would help the cargo carriers to avoid the problem of high rentals charged by the metro airports, is also being examined.

The government has taken proactive steps for the development of airport infrastructure. For instance, in the case of the greenfield airports at Bangalore and Hyderabad, which become operational in 2008, the connectivity projects were also speeded up.

The projected air traffic during 2009-2017 is as under:

Year	Aircraft Movements (in 000)		Passenger (million)		Cargo (000 tonnes)	
	International	Domestic	International	Domestic	International	Domestic
2009-10	311.74	1108.39	40.01	104.75	1445.50	708.39
2010-11	353.09	1275.38	46.45	125.84	1622.33	780.60
2011-12	400.45	1470.99	54.04	151.36	1822.69	860.78
2012-13	441.58	1653.63	61.04	175.64	1998.45	931.91
2013-14	487.36	1862.08	69.05	203.99	2192.47	1009.47
2014-15	538.38	2100.35	78.23	237.13	2406.81	1094.07
2015-16	595.29	2373.13	88.78	275.90	2643.73	1186.39
2016-17	658.89	2685.90	100.93	321.28	2905.79	1287.18

Source: AAI quoted in India Infrastructure Summit, 2009, FICCI

Consequent to the global economic crisis, there has been a decline in air traffic in India. Reports indicate that number of air passengers has declined by 14% in March 2009. Domestic airlines carried 32.2 lac passengers in March 2009 compared to 37.48 lac in March 2008. Infact, the decline in domestic traffic, both passenger and cargo, had begun in July 2008 and has continued throughout. Total traffic (passenger+cargo) during the period April-January 2009 was 0.4% compared to 11.1% during the corresponding period in 2007-08.

However, it is expected that the current slow down in the air traffic will be temporary and once the overall economic situation picks up, there will be a rebound. With India hosting the Commonwealth Games in 2010, the traffic is likely to increase. The projected traffic as indicated in the table above seems achievable due to two reasons. First, once India shifts back to its high growth trajectory, air traffic is bound to increase. Second, there is large suppressed demand for air travel at the regional level. Development of regional airports would give a big boost to such demand. It is therefore imperative that the aviation infrastructure is developed at a faster pace.

The upgradation and modernization of airports as well as the increasing demand for air travel have raised the need for support services such as the setting up of maintenance, repair, and overhaul (MRO) facilities in India, as well as boosting cargo operations by setting up cargo facilities and cargo hubs. It is reported that MRO segment is presently growing at 11% and has the potential of earning revenues of USD 1.17 billion by 2010. It is believed that India can become an MRO hub by capitalizing on manpower arbitrage in India. MRO manpower costs in India range from $30-35 per hour which is almost 60% cheaper than the rates in West Europe or the US, though not significantly different from China or Indonesia. India also has location advantage as there are no MROs within a five-hour fly zone of India

and it can leverage this advantage of being between Europe and Asia Pacific. However, factors such as lack of real estate development, delays in land acquisition, and the lack of trained manpower can impede the growth of MRO facilities.

Over the past few years, the cargo sector has seen some initiatives. Five major airports (Mumbai, Delhi, Kolkata, Chennai and Bangalore) account for 88% of total cargo handled in India. The development of Multimodal International Hub Airport at Nagpur (MIHAN) is the first cargo hub in India which is being implemented. Some foreign logistics and airline service providers have also entered India. However, factors such as fragmented and inadequate ground logistics, including roads and railways infrastructure, lengthy documentation procedures, etc can act as constraint in the development of cargo operations in India.

Airports under the PPP model viz., Bangalore and Hyderabad have been permitted to levy User Development Fees (UDF), while in the case of Mumbai and Delhi, Airport Development Fees (ADF) has been allowed by the government. While views have been expressed that the burden on air passengers has increased as a result, levy of charges has been an international practice. However, there is need to bring about transparency in levy of such charges. The Airport Economic Regulatory Authority (AERA) is expected to become operational soon and may address this issue.

Aviation as a sector is different from other economic sectors, in that its operations are an agglomeration of multiple distinct, yet intertwined, commercial functions in different segments viz., airline companies, ground handling, air traffic control, competition, safety, security, etc. Since airports are natural monopoly, there is need for an effective regulatory mechanism that embodies the principles of fair competition and articulates explicit objectives. With the changing ownership structure, airport regulation now also includes economic regulation. On the recommendations of the Naresh Chandra Committee report, the Airport Economic Regulatory Authority (AERA) has been set up as an independent regulator. The AERA Act 2008 stipulates that the regulatory authority would determine the tariff at major airports, the services provided, its quality, the cost for improving efficiency, economic and viable operation of major airports, revenue received from services other than aeronautical services and also determine the amount of development fees and air passenger service fee. The authority would ensure transparency by holding due consultations with the stakeholders.

Thus, despite the recent downturn in the civil aviation industry, future growth potential appears strong. Adoption of PPP model for creation of airport infrastructure could help in mobilizing more private investment and limited use of public resources.

On its part, IIFCL has financed along with other lending banks/institutions two metro airport projects viz., Mumbai and Delhi. The total loan sanctioned by the company to these airports is Rs2150 crore.

IIFCL : PROGRESS ACHIEVED 31st March 2009

Loan Sanctioned

Rs crore

Sector	No. of Projects	Project Cost	Loan Sanctioned
Road	57	35,293	6,063
Port	5	3,772	580
Power	23	93,241	9,913
Airport	2	14,716	2,150
Urban Infrastructure	1	70	14
PMDO*	19	2111	40
	107	**149,203**	**18,760**

*Pooled Municipal Debt Obligations

Financial Closure Achieved

Rs crore

Sector	No. of Projects	Project Cost	Loan Sanctioned	Amount Allocated
Road	52	29,768	5,355	3,826
Port	5	3,772	580	476
Power	18	67,363	8,453	7,523
Airport	2	14,716	2,150	848
Urban Infrastructure	1	70	14	14
PMDO	10	1,347	19	19
	88	117,036	16,571	12,706

Total Disbursements

Rs crore

	Total Disbursements	
Sector	No of projects	Amount
Road	46	1947.61
Power	15	2252.92
Port	3	150.06
Airport	2	516.47
Urban Infra	1	1.81
PMDO	10	12.04
Total	77	4880.91

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