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HYBRID ANNUITY MODEL

Revival of the Road Sector

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With development of road sector having hit a roadblock due to dwindling private sector interest, the introduction of the Hybrid Annuity Model of development has revived the sector with both private sector as well as lenders warming up to this new model of development.



Development of roads and highways has lately been a priority of successive governments, however the expected growth in the sector was hindered by numerous sector specific challenges that impeded the desired growth outcome. The need for better roads cannot be over emphasized as connectivity has globally improved the lives of countries and communities by linking workers to jobs, producers to markets, students to school and the sick to hospitals, hence, roads are critical to any development agenda. At present India has an extensive road network of 3.3 million km. Roads, carry about 65% of freight and 80% of passenger traffic in the country. This network includes expressways, national highways, state highways, major district roads, city roads, village and rural roads etc. Among all the infrastructure sectors, road transport contributes the most to the country's GDP.

The Indian economy has achieved rapid growth in the infrastructure space. This sector also attracted huge investments from private sector with global companies vying for a share in the pie. With a view to attract private sector capital the government introduced Public Private Partnership (PPP) models for project development.

The often employed modes of PPP in the highway development have been :

Build Operate Transfer (BOT) Annuity Model- Under the BOT annuity model, a developer builds a highway, operates it for a specified period and then transfers it to the government. It is after the launch of commercial operation on the project that the government begins to reimburse the developer by way of guaranteed annuity payments.

Build Operate Transfer (BOT) Toll Model- Under the BOT Toll model, a developer invests in the construction as well as operation and maintenance of the project. It is through collection of toll that the developer's investments are recovered. This model of finance affected the investors adversely with the regulatory, environmental, social, finance, revenue, traffic risks being stacked against the private sector developer. Recoveries took long time coming due to prolonged construction period which was a result of slow regulatory approval process.

This further led to insolvency of companies and increased liability of non-performing assets on the bank. The other model used by the government was Engineering Procurement Construction (EPC) Model. The EPC model is a turkey model where the entire cost of the project is borne by the government hence it is clear of any land, traffic and/or revenue risk. While this model is beneficial for the private sector it remained a costly model for the government, hence financially not very feasible.

Owing to the challenges posed by these PPP models government introduced a new model of private participation called the Hybrid Annuity Model (HAM). This model was a combination of BOT and EPC . Under the scheme of HAM the government provides 40% of the project cost in the initial five years, in tranches linked to clear milestones and the remaining 60% of the project cost has to be generated by the developer by a combination of debt and equity

The initial payment by the government ensures liquidity and reduces the financial burden on the private party during the construction period, The remaining 60% of the project cost is paid as deferred annuity paid over the term of the project, depending upon value of assets created.

The National Highways Authority of India (NHAI) is responsible for revenue collection; the private party has no right or obligation to collect toll. The ownership of the road asset lies with NHAI. This scheme ensures that the risk is evenly spread between the authority and the concessionaire.

Hybrid Annuity Model in Social Sector?

In an environment of constrained economic resources, a PPP model that improves efficiency can be an option worth considering. PPP models such as HAM that foster performance based management must be encouraged. Sectors amenable for such models include water supply, sanitation, solid waste management, road maintenance etc.

HAM has increased the level of investment resulting in revival of the road sector through renewed interest of private investors. This model can be useful in attracting investments in the neglected social sectors and which will result in the provision of necessary capital influx required for funding critical social sector projects that are otherwise not considered viable.

Use of HAM in the National Mission for Clean Ganga

The river Ganga which runs through the northern and eastern part of the country is highly polluted. Numerous plans were smothered in the pipeline due to lack of adequate resources, poor interest and frugal investment in achieving the objective of clean Ganga. In order to bring back the momentum in the Ganga clean-up process Hybrid Annuity Model has been introduced for wastewater treatment. The hybrid annuity-based public-private partnership model has been adopted to ensure performance, efficiency, viability and sustainability. An important feature of HAM is that both the Annuity and O&M payments are linked to the performance of STP, which was not the case earlier when the projects were implemented under EPC or DBOT mode. This would ensure continued performance of the sewage infrastructure assets created due to better accountability, ownership and optimal performance.

Sewage Treatment Plants. -As part of the Clean Ganga Mission, the introduction of HAM in social sector has attracted investments from private investors. Sewage treatment plants are being set up on PPP basis under HAM in cities like Haridwar, Varanasi that lie on the bank of Ganges.

Conclusion

Sustained investments in the infrastructure sector is key for economic growth. Therefore, it is important that the projects on the shelf take off. HAM is also being tested in urban infrastructure developments such as metro rail projects. After assessing the feasibility and benefits of HAM in the infrastructure sector, it may be worthwhile to replicate this model in other social sectors which require humongous investments to get off the ground and where the private investment is usually just a trickle.

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