Indian power chasing the dollar

24/05/2010

India has a full pipeline of power deals to finance over the coming years. There is local bank appetite and capacity for Indian power risk but, in the absence of international lending to these projects, Indian banks are starting to hit their sectoral exposure norms.

India has been working hard to up its electricity generation, most notably through its Ultra Mega Power Projects (UMPP), a series of 4GW plants that are part of an overall plan to add around 100GW to the national grid over the next five years.

So far, the government has awarded four of the nine projects originally planned – Mundra in Gujarat (Tata Power), Sasan in Madhya Pradesh (Reliance Power), Krishnapatnam in Andhra Pradesh (Reliance Power) and Tilaiya in Jharkand (Reliance Power).

Two UMPPs have been financed to date – Mundra and Sasan – and Reliance's Krishnapatnam project is being financed now, with IDBI as financial adviser. While Mundra featured dollar and ECA debt, the more recent deals are being, or have been, done with pure rupee debt.

The Rs130 billion ($2.9 billion) syndicated debt for Krishnapatnam is set to close in late June. Lead arranger IDBI has been out to banks for the 15-year debt since March, has taken commitments for 30% of the total amount, and expects another 30% to come in over the next few weeks. The bank group is expected to feature around 25 lenders. Pricing will be between 11% and 11.5% all-in.

Although Krishnapatnam demonstrates the growing reliance on rupee-only debt for big power deals, Reliance Power will look at refinancing a portion of the debt with dollars after financial close, and is expected to go out to banks including HSBC, Citi and Standard Chartered, as well as Chinese ECAs, as the plant's equipment is being supplied by Shanghai Electric. This partial dollar-refinancing model is also seen on Reliance's Sasan UMPP financing where Standard Chartered is mandated to replace around 30% of the rupee debt with dollar debt. The deal could feature Chinese banks, and will have a tenor of 12 to 15 years.

Dollar debt

Over the past 18 months, international debt has not been competitive in relation to local Indian debt. For example, a hypothetical deal with a floating Libor of 50bp would shift to a fixed dollar rate of around 200bp. With a currency risk hedge, this would push the underlying price to around 800bp, and the lending spread would take this up to around 12% all-in. This is a clear 50bp to 100bp higher than a more typical rupee margin of 11% all-in.

Although the dollar debt would be priced at a fixed rate across tenor, giving more certainty of cost, and the rupee debt would be reset annually in line with SBAR or an average of the participating banks' prime lending rates, recently, Indian interest rate resetting has been working to the benefit of sponsors.

Shorter tenors from international lenders is another major hurdle – while Indian banks are comfortable with the systemic risks that come with lending to Indian power projects and tend to lend 15-year money, at the moment internationals are not comfortable enough to run tenors out beyond around 10 years, and would prefer more like eight. The main perceived systemic risk in the sector is that the state utilities historically have not been seen as robust enough to support power purchase agreements. Added to that, in the event of default, under the Indian Securities Act, offshore lenders do not have the same right to call loans in as Indian banks, giving them an implied junior status. There are calls for this to change, and word in the Indian banking market is that it could, but a legislative shift is not on the immediate horizon.

On the upside, offshore lenders, including ECAs, are reportedly becoming more confident about taking Indian power risk, partly as a result of the ratings agencies changing India's status. In March, Standard & Poor's raised the country's BBB- rating to "stable" from "negative", on the basis that the economy's increased growth will help the government cut its budget deficit. However, credit rating shifts aside, developers would need to see currency hedge prices drop significantly in order for international debt to be a competitive option.

Exposure norms

Greater availability of more competitively priced offshore debt would take pressure off local lenders. At the moment, each domestic bank has sectoral exposure norm thresholds, and the power threshold for all lenders sits between 8% and 10%. Some Indian banks are looking to increase their sectoral norms for power this year, and sponsors would be more confident about financing the government's ambitious power-delivery plans if the norms were more like 12% to 15%.

Power financings such as Sasan, with its post-close option to refinance up to 30% of undrawn rupee debt with ECB debt, are testament to the effect of the exposure norms. For instance, Reliance has two more UMPPs – Krishnapatnam and Tilaiya – to finance in the immediate future, and if these deals are to be done with predominantly rupee-denominated debt, pressure will need to be taken off lenders to free-up capacity.

The option to partially refinance rupee debt with ECB facilities is not unusual in big power deals – CLP Power India's 1.32GW Jhajjar deal, which closed in September 2009, also carries the option, as will the Krishnapatnam UMPP. The option has been a limited one though – only applying to undrawn portions of rupee debt, and therefore not something that could be approached as a true refinancing.

However, at the beginning of April, the RBI sent out a circular stating that it was relaxing its rule on such refinancings to allow borrowers to replace drawn rupee debt, rather than undrawn-only. But borrowers will still limit how much foreign currency refinancing they do, as currency hedges are very expensive.

ECB prospects

The RBI, in its Annual Policy Statement for 2010-11, raised the bank cash reserve ratio by 25bp to 6%. This will obviously increase the price of rupee-denominated debt (one Indian syndications banker has predicted an adjustment of 50bp to100bp on 15-year debt), but whether this will make foreign debt more competitive than it is now will depend on more than pricing.

One important obstacle to international banks lending to big Indian power deals is that they need more time to perform due diligence on projects, and the developers, which are in a hurry to tie deals off, are far more likely to go to Indian banks, which are more relaxed about due diligence and need less time to assess risk on projects. The price that the developers potentially face for going local is that of interest rate hikes, as the margins on the rupee debt will be reset on an annual basis.

When it comes to a possible increasing role being played by ECAs, which would offer longer-tenor debt than the commercial banks, the time factor is even more of an obstacle. With Indian developers entering into equipment supply contracts with Chinese, Korean and, going forward, Japanese manufacturers, it might look likely that a new and varied world of affordable debt might open up, but the attitude towards ECA debt in the Indian power market is not entirely positive, as the ECAs are seen as being even more exacting than the international banks. As one senior Indian project banker puts it, "The ECA route is attractive, yes, but the ECAs are finicky – developers do look at going for debt with them as an option, but in the end they can't face the time taken, covenants and stress."

However, this question of how long a deal takes to bank as a result of due diligence and the drawing up of covenants are issues that could soon be forced by Indian banks' sectoral exposure norms. Once the local lenders reach their limits, debt will still need to come in for these multi-billion dollar deals, and dollar debt is something that will have to be examined more closely, whether or not its price tightens or its tenor lengthens.

The next UMPP deal to come to market will be Reliance Power's Tilaiya plant in Jharkand. It will cost $4.5 billion, and the market expects it to be part-financed in dollars, possibly following a structure similar to that of 2008's Mundra deal, with a blend of ECAs, development banks and international lenders providing around half of the total debt requirement. This will be driven by Indian banks edging closer to their sectoral exposure norms, a growing confidence among offshore banks regarding Indian country and offtake risk, a gradual drop in currency hedge prices and the willingness of the developers to accommodate offshore lenders' need to take time over due diligence.