

# IL&FS: project finance SPVs risk default

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A recent ruling by the National Company Law Appellate Tribunal granting a blanket moratorium on all debt repayments has thrown fresh doubt on the fate of debt issued by Infrastructure Leasing & Financial Services (IL&FS) project finance special purpose vehicles (SPV).

IL&FS was taken over by the Indian government in [early October](#) (2018) after defaulting on a series of commercial paper and loan payments. IL&FS has total debts of around Rs910 billion (\$12.9 billion).

The company [submitted its restructuring plan](#) to the courts in November, involving a capital infusion as well as divestures and potentially liquidation of unviable assets.

Arpwood Capital and JM Financial are advising IL&FS.

So far, the ring-fenced project finance SPVs have continued repayments, but a court ruling this week (January 2019) has cast doubt on the fate of the instruments.

Following the ruling, two SPVs – Jharkhand Road Projects Implementation Company (JRPICL) and West Gujarat Expressway (WGEL) – have written to trustees not only warning they would stop upcoming repayments but also demanding a refund on repayments made since October (2018).

In theory, the project finance SPVs have a “well-defined waterfall mechanism for project finance, backed by a ring-fencing mechanism from project cash flows. The ring-fenced and escrow structure enables the project cash flows to remain intact until debt obligations and other covenant are met and financial agreements ensure reasonable remoteness to the sponsor’s bankruptcy. Therefore, irrespective of sponsor’s credit profile (subject to O&M performance), the ring-fencing mechanism ensures debt service,” according to India Ratings & Research associate director Vishal Kotecha.

The SPVs continue to generate cash flow and Kotecha is expecting lenders to instruct the trustees and the escrow bank to release the payments.

However, a suspension or even termination of repayments would trigger a downgrade to default or ‘D’, according to the credit rating agency.

Also, “such defaults by JRPICL and WGEL (and any other IL&FS SPV) will not only destabilise all their ratings but also raise question on the effectiveness of their ring-fenced structure,” Kotecha said.

In light of the new development, India Ratings & Research is also warning several other project finance SPVs still rated ‘AAA’ or ‘AA’ may be at risk of downgrade to default. These include:

- Hazaribagh Ranchi Expressway – AAA
- Jharkhand Road Projects Implementation Company – AA
- Jorbat Shillong Expressway – AAA
- North Karnataka Expressway – AA+
- West Gujarat Expressway – A

In general, a project finance SPV is rated on the basis of a steady stream of cash flows from the counterparties, as well as comfortable cash flows and robust liquidity position.

Investors, lenders and trustees have the right to monitor the cash flow waterfall arrangement and their steps in rights are supposed to kick in as and when the situation demands.

In addition, many SPVs maintain at least a six-month equivalent of debt service reserve and have commensurate debt service coverage ratios, according to Kotecha.

A default by the project SPVs would be in “contravention to the spirit of the financing documents”, he said.

“Such global practices are imbibed in the fledging Indian market. Failure to adhere to such structures, which are critical for long-term infrastructure financing, could increase the risk premium on such funding and even put future debt issuances at risk,” Kotecha said.

For the sake of the Indian market, “a public clarification of the legal position of the ring-fenced SPVs executing and operating public-private partnership projects vis-à-vis a subsidiary, and perhaps even a separate enactment for public infrastructure projects operating on the SPV mechanism” should be issued, according to Kotecha.

In total, the agency has ratings on Rs1.6 trillion worth of infrastructure SPV debt in India.

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