

PRIVATE FUNDING FOR INFRASTRUCTURE

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The last two decades has seen an unprecedented growth of cities and urban population in India. It consists of over 1/3rd of the total population and is distributed over a large number of urban human settlements.

The 74th Constitution Amendment has reinforced the important aspect of urban local bodies, which are to meet the expenditures incurred on providing civic services. The growth of urban population and cities has had to a tremendous strain on the physical environment and infrastructure in particular. If not augmented it would act as impediments to the growth of the cities.

Urban Infrastructure comprises of various sectors, which are needed for the proper running of the city like water supply and sanitation, public transportation, roads, electricity, etc.

Traditionally, governments and state owned agencies have done delivery of infrastructure services in most economies like India. Many governments, particularly in developing economies have now sought to involve the private sector to participate in infrastructure projects. The reasons for opening the infrastructure sector for private investment by the government is to meet the huge financial demands and use their expertise in the construction and operation of the projects. Unlike the conventional financing, private investment in infrastructure projects need to comprehensively incorporate all aspects of risk and return on a project finance basis where there is limited recourse or non recourse financing. This is normally possible by establishing a Special Purpose Vehicle (SPV) and justifying the return through the cash flows of these specific projects.

In this column, I will discuss briefly the three popular arrangements of private sector financing - BOT (Build - Operate - Transfer), BOO (Build - Own - Operate) and BOOT (Build - Own - Operate - Transfer). The differences between BOT, BOO and BOOT arrangements can be seen through three phases of the project viz. Development, Operation and Termination. The degree of privatisation increases correspondingly as we go from BOT to BOOT to BOO format.

In a typical BOT model, the government entity enters into an agreement with a private sector company to finance, design and build a facility at its own cost. The private companies are then given a concession, usually for a fixed period to operate that facility and obtain revenues from its operation before transferring the facility back to the government at the end of the concession period. This enables the project company to receive sufficient revenues to service its debts during this period. Road projects primarily opt for BOT format where the private company is also given the responsibility of maintaining and collecting the toll during the concessionaire period. After the completion of the period it transfers the operation to the government. It must be understood in the BOT format at all times title to the assets of the concession (mainly land) will remain vested in the public authority.

Under the BOO format, the ownership of the asset is retained in perpetuity by the private developer. This is more popular in power plants where the private developers own the plant and

are governed by a power purchase agreement, which is usually a fixed term contract. The physical assets of the project do not revert to the state after the concession period is over.

In a BOOT project, the ownership is vested with the private developers, albeit temporarily & a terminal payment is made to the project developer during the asset transfer process at the end of the concession period.

In any project, the structure needs to be finalised keeping in mind the various related issues through a techno-economic feasibility study. It has been seen that the largest number of World Bank projects have found their way in the roads and power sectors.

The BOT format has achieved reasonable success in the road and transport sectors because of the monopoly the sector enjoys. On the other hand, cost, efficiency and better services have been seen in the power sector through BOO format because of the competition and service provider nature of this sector.

It is about time that the government takes bold decisions for private participation in infrastructure development. People are now willing to pay a reasonable rate for better services like roads, power, water, etc. Except the project with a social or strategic commitment, no infrastructure project should be unviable in the long run. Infrastructure projects should not be necessarily always seen as stand-alone since they are the engines for growth and should be seen as major contributors to the overall development and providers of direct/indirect benefits to the area. All these issues need to be kept in mind while structuring the project and involving the private sector to meet the huge demand of funds and provide technical expertise required for growth.