International Journal of Structural and Civil Engineering Research

ISSN 2319 – 6009 www.ijscer.com
Vol. 2, No. 4, November 2013

Research Paper

VIABILITY GAP FUNDING SCHEME FOR INFRASTRUCTURAL DEVELOPMENT

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India has one of the largest road networks in the world, aggregating around 3.3 million km. historically, the budgetary resources from the governments have been the major source of finance for infrastructure such as road projects. The reduction in the budgetary allocation towards roadway and increasing demands from other sectors, such as social and economic infrastructure and the limitations in the traditional public procurement system, have resulted in deficiencies in the road network leading to capacity constraints, delay, congestion, fuel wastages. In order to remove the deficiencies and to upgrade the road network to world-class standards, Ministry of Finance Department (MFD) and Department of Economic Affairs (DEA) have introduced a scheme to support the Public Private Partnership (PPP) in infrastructure. Government of India (GOI) has made provision to financially support the viability gap to the tune of 20% of the cost of the project in the form of capital grant from its viability gap fund. The scheme is confined to PPP projects taken by the GOI or its agencies, where the private sector is selected through open competitive public bidding. Infrastructure development is a crucial sector recognized in the current Five Year Plan. Even State Government's vision 2020 envisages huge requirement of Rs.169,918 cr considering five years' shelf of projects in various sectors. Similarly such projects are not financially viable on stand alone basis as they have long gestation period and having limited financial return. Hence, they are not attractive to the private sector. State government has therefore introduced a new scheme for extending financial support to such PPP Projects in the sectors of infrastructure called as Viability Gap Funding Scheme (VGF).

Keywords: VGF, Road network, Infrastructure, PPP, Investment

INTRODUCTION

In a view to support the infrastructure projects financially, Viability Gap Funding Scheme was announced in year 2004 and the modalities to operationalise it in year 2005. The scheme aims to ensure wide spread access to infrastructure provided through the PPP framework by subsidizing the capital cost of their access (A report by GOI, 2008). To make essential projects economically commercially viable gap funding scheme from GOI would obviate the need for such projects and allow

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private sector participation in the projects, facilitating private sector efficiencies in infrastructure development.

Such scheme provides financial support in the form of grants (one time or deferred) to infrastructure projects undertaken through PPPs with a view to make them commercially viable. Such scheme provides total VGF upto 20% of the total cost of project. Scheme is normally in the form of a capital grant at the stage of project construction. The guidelines for financial support to PPPs in infrastructure were issued by Ministry of Finance in January 2006 (National Solar Mission Phase 2, 2012).

The guidelines essentially flow from the provisions of the scheme, approved by Cabinet Committee on Economic Affairs (CCEA) in 2005, and prescribe the procedure to be followed for posing the proposals for seeking VGF for PPP projects (A report by GOI, 2008).

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WHAT IS VIABILITY GAP FUNDING (VGF) SCHEME

Infrastructure projects have long gestation periods and in most cases, are not financially viable on their own. It may not be possible to fund the very large investment requirements of these projects fully from the budgetary resources of the GOI alone. In order to remove this shortcoming and to bring in the private sector resources and techno-managerial efficiencies in flow, the GOI is promoting PPP in infrastructure development through a special facility envisaging support to any PPP projects through VGF. Primarily, this facility is meant to reduce capital cost of the projects by credit enhancement, and to make them viable and attractive for private investments through supplementary grant funding. Provisions for this facility are made on year to year basis[5].

CRITERIA FOR FUNDING THE VGF SCHEME

Following is the eligibility criteria for funding VGF scheme:

i. The project must be implemented (i.e., constructed, maintained and operated during the project term, by an entity with at least 40% private equity.

ii. The project must belong to one of the following sectors:

   a. Roads, railways, seaports, airports;

   b. Power;

   c. Water supply, sewerage and solid waste disposal in urban areas; and

   d. International convention centers.

iii. The projects should have been vetted/ endorsed by the concerned line ministries in the GOI.

iv. All central projects should have received requisite government's approval at the appropriate level.

v. The total government support required for the project, including support from the GOI under this facility, or any other sources of GOI and its agencies, must not exceed 20% of the total project cost (lesser of estimated preliminary project cost or the actual project cost).

vi. The implementing agency must be selected through a transparent and open competitive process.

The main criterion for selection will be the extent of VGF required by the private partner to successfully implement the project. The extent of VGF shall be determined on the basis of the net present value of the actual VGF required. For this purpose and for all calculations under these guidelines, the rate of discount shall be the rate of interest on 10-year gilts on the date of submission of the bid[4].

FUNDINGS

VGF can be in different forms, including but not limited to capital grant, subordinated loans, O&M support grants or interest subsidy. A mix of capital and revenue support may also be considered. Different forms of VGF's are as follows:

i. The funding is to be disbursed contingent on agreed milestones, preferably physical, and performance levels being achieved, as detailed in funding agreements.

ii. The funding is to be provided in installments, preferably in the form of annuities, and with at least 15 % of the funding to be disbursed only after project is fully functional.

iii. In the first year of the facility, funding is to be allocated to projects on a first come, first served basis subject to meeting the eligibility criteria.

APPRAISAL AND APPROVAL PROCEDURES

An Empowered Committee has been set up in the DEA under the Additional Secretary (EA) to consider and authorize the sanction of funds up to Rs. 50 cr beyond which approval of the Finance Minister will be required. The projects may be posed by any (a) public agency at the centre, state or urban local body which owns the underlying assets; (b) private agency with sponsorship from the relevant central or state government agency. Project proposals must be accompanied by a preliminary project appraisal (covering (a) techno-economic viability of the project, (b) financial appraisal and project financing arrangements, and (c) extent and nature of viability gap funding proposed) and a commitment letter on behalf of the lending institutions. After approval of the project by the Committee within 30 days of submission the project will be put to bid by the public agency concerned through transparent and open competitive bidding indicating the extent of VGF that is actually required. The lead financial institution will present its detailed appraisal of the technical and economic viability of the project as proposed by the successful bidder, for the consideration of the Committee. The transfer of VGF and the schedule of such transfers will be approved by the Committee. The leading financial institution will undertake regular monitoring and evaluation of project compliance with agreed milestones and performance levels.

FINAL APPROVAL BY THE EMPOWERED INSTITUTION

Within three months from the date of approval, or such extended period as may be permitted, the Lead Financial Institution shall present its appraisal of the project in six copies (both in hard and soft form) for consideration and approval of the Empowered Institution. The appraisal shall be accompanied by an updated application in the format specified along with the project report and project agreements. The Leading Financial Institution shall verify the contents of the application and convey its recommendation to the Empowered Institution. Prior to final approval by the Empowered Institution, the Ministry, State Government or statutory authority.

The procedure specified in above shall be followed mutatis mutandis for examination and approval of the appraisal report of the Lead Financial Institution[2].

DISBURSEMENT OF VGF

1. A grant under VGF Scheme shall be disbursed only after the Private Sector Company has subscribed and expended the equity contribution required for the project and will be released in proportion to debt disbursements remaining to be disbursed thereafter.
2. The Empowered Institution will release the Grant to the Leading Financial Institution as and when due, and obtain reimbursement thereof from the Finance Ministry.
3. The Empowered Institution, the Leading Financial Institution and the Private Sector Company shall enter into a Tripartite Agreement for the purposes of this Scheme. The format of such Tripartite Agreement shall be prescribed by the Empowered Committee from time to time[2].

MONITORING

The Leading Financial Institution shall be responsible for regular monitoring and periodic evaluation of project compliance with agreed milestones and performance levels, particularly for the purposes of disbursing the VGF. It shall also send a quarterly progress report to the Empowered Institution[6].

CONCLUSION

1. VGF can be one of the resource for any infrastructural development.
2. VGF implement the project without causing stress to the financials.
3. VGF results in transparency and standardization in the manner how grants are released.
4. This facility reduces capital cost of the projects by credit enhancement, and make them viable and attractive for private investments through supplementary grant funding.
5. VGF provide a broad framework and a conducive environment so that the strength of private sector in terms of their efficiencies, flexibility and innovativeness are utilized to provide better infrastructure and services at an optimal cost and for better ‘Value for Money’ to the users.

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