



## GRADING OF INFRASTRUCTURE PROJECTS

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## **GRADING OF INFRASTRUCTURE PROJECTS**

The grading of infrastructure projects derives its importance from the public-private partnership (PPP) model adopted by a Government. By grading a project, CARE would give an independent opinion on the different risks associated with the project at various levels. Since, under the PPP model, the Government transfers a major portion of the project risks to the private parties, CARE's grading would help the prospective bidders in getting a holistic view of the risks associated with the projects. Further, as the grading would break the proposed project into various risk heads, it will also help the Government in defining superior risk allocation frameworks as well as developing advanced processes for identifying the best-fit sponsor.

CARE would grade an infrastructure project at two stages:

- I. Pre-bid
- II. Implementation

### **I. Pre-bid**

CARE's grading of a project at the pre-bid stage would essentially be a comment on the risks involved in undertaking the project. The grading would be based on a 5-point comparative scale, IP1(Pb) to IP5(Pb), with IP1(Pb) implying minimal project risk and IP5(Pb) implying very high project risks, as compared to other infrastructure projects at the pre-bid stage. In order to arrive at the above grading, CARE would "carefully" examine a project's features to evaluate the following:

- Adequacy/Completeness of the risk allocation framework
- Ability of the nodal authority/agency to deliver on its commitments
- Adequacy of the selection process
- Risks associated with Project-specific parameters.

A. Adequacy/Completeness of the risk allocation framework

Under the PPP model followed in countries like India, the project details are worked out by the Ministry sponsoring the project and the terms of concession are put forth. These terms of concession (Concessions Agreement) broadly determine the risks associated with the project. In its first step of evaluation, CARE would examine these terms for the clarity of their definitions, their inherent risks - which are irrespective of the project developer - and the rewards thereon. A concession agreement with well-defined terms and conditions, optimum risk allocation and suitable rewards for the risks allocated would be considered as adequate/complete by CARE. For instance, in power projects it's pertinent that risks related to environmental clearances, forest clearances, Resettlement and Rehabilitation (R&R) and off-take arrangements are well documented.

B. Ability of the nodal authority/agency to deliver on its commitments

In this step, CARE would evaluate the role and responsibility of the various nodal agencies as per the terms of the concession agreement. The ability of the various parties involved to meet their commitments and liabilities would be examined by CARE. For this, CARE would take into account their constitutional authorities and their past track records, amongst other parameters depending on the nature of the commitment. An example in this regard could be the extent to which state governments support (both stated and unstated) will be examined. The State government's support and its commitment towards issuing notification for land acquisition has become a major issue in infrastructure projects.

C. Adequacy of the selection process

Until this step, CARE would have evaluated the various risks related to the project, independent of the developer. However, for the successful implementation of a project, it is necessary to select the developer with the most suited set of skills. Keeping this in mind, in this step, CARE would

evaluate the sufficiency of the selection process in identifying the developer who would be the best fit sponsor, given the various risks involved. CARE would take a view on the design of the bid process, the qualifying criteria and the bidding criteria. For instance, in Power Projects, CARE would examine the deviations from Standard Bid Documents (SBDs) and identify the rationale for such deviations. Further, we may also compare the selection process with international best practices.

#### D. Risks associated with Project-specific parameters

Every project, by its very nature and scope, is different from other projects in one way or the other. Thus, any assessment of a project would be incomplete without assessing the parameters specific to the project. With this in view, CARE would evaluate the micro-economies of the project like construction costs, cost of equipments, location of the project, availability of land and related infrastructure, to name a few. For instance, risks associated with fuel supply and availability in case of power plants would be examined. This may include analysis of fuel blocks allocated and estimating the supply projections over the life of the project.

## **II. Implementation**

CARE's grading of infrastructure projects at the implementation stage would be an opinion on the risk associated with the implementation of the project, measures taken to mitigate the same, ability of the management to complete the project within the specified parameters and timeframe, as well as adequacy of cash flows to service debt. In this regard, the grading would be different from a normal credit rating, which is an opinion on the debt repayment capability of the borrower.

The grading, as in the case of pre-bid, would be based on a 5-point comparative scale, IP1 to IP5; with the level of the underlying risk increasing from IP1 to IP5. The grading would be awarded after a thorough analysis of

the detailed project report, feasibility study report, concession agreement and other individual contracts, in order to evaluate the following:

1. Risk allocation framework and project parties
2. Project-specific parameters
3. Projected financials

#### 1. Risk Allocation Framework and Project Parties

The risk allocation matrix worked out by the sponsoring ministry outlines the risks that the ministry holds back and the risks transferred to the developing party. The developing party then works out its own risk allocation framework, whereby it identifies the risks that it would undertake on its own and the risks that it would transfer to third parties. CARE would evaluate the adequacy of this risk allocation framework in mapping the risks to parties most suitable for undertaking them. For this evaluation, CARE would analyze the strengths and weaknesses of the developer and the third parties to whom the risks have been transferred, for their ability and sufficiency in carrying out the work contracted to them. The nature and scope of this evaluation would depend largely on the risk allocation framework planned by the developer.

*CARE would identify the various risks passed on to the project developer as per a risk allocation matrix. CARE would then evaluate risk allocation framework mapped by the developer to handle/mitigate such risks. For this evaluation, CARE would analyze the strengths and weaknesses of the developer and the various other parties to whom the risks have been transferred, for their ability and sufficiency in carrying out the work contracted to them. The nature and scope of this evaluation would depend largely on the risk allocation framework planned by the developer.*

#### 2. Project-specific Parameters

The key determinants of the risks involved in a project are issues like availability of land and related infrastructure, accessibility of the project site, status of clearances, sourcing of materials etc. The criticality of these issues depends largely on the nature and scope of the project. Hence, it becomes

imperative to define the parameters critical to a project and evaluate them on a stand-alone basis, rather than analyzing a common set of parameters for every project. For the purpose of the identification and analysis of project-specific parameters, CARE would rely on the DPR as well as on its own understanding from grading projects of similar nature, scope and size.

### 3. Projected Financials

For a project to be successful, it should necessarily be technically feasible and economically viable. Whereas technical feasibility of the project would be assessed largely in the pre-bid stage, the post bid analysis will have a larger focus on the economic viability of the project. Thus, CARE would undertake a detailed examination of the validity of the various assumptions underlying the economic forecasts of the project. CARE would further evaluate the project cost, means of finance, expected revenues and expenses, and adequacy of the cash flows to meet the various obligations. CARE would also sensitize the expected revenues and expenses by identifying key factors that would bring cause the expected revenues or expenses or both to digress from the estimates.

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