

# Overview of the framework

## Need for a framework

Economic growth in recent years has enhanced the relevance of railways as a critical element in global competitiveness of the Indian economy. In particular, this sector has witnessed significant interest from both domestic as well as foreign investors following the policy initiatives taken by the Government to promote Public Private Partnerships (PPPs). However, the actual inflow of investment has been less than expected, and future prospects will depend on adoption of a comprehensive policy and regulatory framework necessary for addressing the complexities of PPP, and particularly for balancing the interests of users and investors. Moreover, transformation of rules will have to be accompanied by a change in the institutional mindset.

**Railways affect global competitiveness**

For building and operating world-class railway stations through PPP, a precise policy and regulatory framework is being spelt out in this Model Concession Agreement (MCA). This framework addresses the issues which are typically important for limited recourse financing of infrastructure projects such as mitigation and unbundling of risks; allocation of risk and rewards; symmetry of obligations between the principal parties; precision and predictability of costs and obligations; reduction of transaction costs; force majeure and termination. It also addresses other important concerns such as user protection, independent monitoring, dispute resolution and financial support from the Government.

The MCA also lays out a structure for commercialising the railway stations in a planned manner through optimal utilisation of resources on the one hand and adoption of international best practices on the other. The objective is to secure value for public money and provide efficient and cost effective services to the users.

**Comprehensive redevelopment is necessary**

### **Project structure**

For the redevelopment, operation and management of a railway station, the framework in this MCA provides for: (a) redevelopment of the railway station including development of real estate; (b) operation and maintenance of the railway station; and (c) construction of buildings for use by the Government for its offices, rest houses and residential accommodation.

### **Elements of financial viability**

The four critical elements that determine the financial viability of a railway station project are concession period; passenger volumes; user fees and revenue from real estate; and capital cost. The concession period for such capital-intensive projects is normally between 50 and 60 years. This timeframe should enable a robust project structure and any further extension in the concession period would improve financial viability only marginally as the present value of projected revenues after 50 years would be comparatively low from the Concessionaire's perspective. Passenger volumes would continue to grow in line with the growth trends applicable to railways and they cannot be altered by the Concessionaire.

User fees would have to be kept low so that the railways remain an affordable means of transport for the common man. Only the revenues from real estate can be increased substantially depending on the extent of development rights granted to the Concessionaire.

**Capital Cost is the key element**

Three of the four parameters stated above would thus be virtually pre-determined, hence, capital cost is the variable that will determine the financial viability of a station redevelopment project. If the potential for real estate revenues is inadequate, bidders may seek an appropriate capital grant/subsidy from the Government in order to reduce their capital investment for arriving at an acceptable rate of return.

As such, reduction in capital costs and phasing out some capital expenditure can help improve project viability significantly.

### **Technical Parameters**

Unlike the normal practice of focussing on construction specifications, the technical parameters proposed in the MCA are based mainly on output specifications, as these have a direct bearing on the level of services for users. Only the core requirements of design, construction, operation and maintenance of the railway station are to be specified and enough room would be left for the Concessionaire to innovate and add value.

**Technical parameters will focus on the level of service for the users**

In sum, the framework focuses on the 'what' rather than the 'how' in relation to the delivery of services by the Concessionaire. This would provide the requisite flexibility to the Concessionaire in evolving and adopting cost-effective designs without compromising on the quality of service for users. Cost efficiencies would occur because the shift to output-based specifications would provide the private sector with a greater opportunity to innovate and optimise on designs in a way normally denied to it under conventional input-based procurement specifications.

### **Performance standards**

For a railway station project, the Concessionaire would not only procure the civil works and equipment, it would also provide services to the users. The efficiency of its operations would normally be reflected in the quality of services provided to the users. The MCA, therefore, identifies the key performance indicators relating to the operation and upkeep of the station building, car park, parcel facilities etc. and specifies penalties for failure to achieve the requisite levels of performance, especially in relation to user services.

**Performance standards to be enforced**

## Concession period

**Concession period to be normally fifty years plus**

The concession period should normally be long enough to enable the concessionaire to recover its investment with a reasonable rate of return. In the case of a railway station, the traffic build-up will be gradual and the investments in infrastructure as well as the real estate may take long to recover. As such, a total concession period of 50 to 60 years has been provided. This would enable the Concessionaire to realise the full potential of the project and thus offer a competitive bid. A shorter concession period would require a greater capital subsidy and/ or higher user charges.

The time period required for construction of the railway station (about three years) has been included in the concession period so as to incentivise early completion that would maximise the revenues of the Concessionaire.

## Selection of Concessionaire

**Competitive bidding on single parameter will be the norm**

The Concessionaire would be selected through a process of open competitive bidding. All project parameters such as the concession period, user fee, price indexation and technical parameters are to be clearly stated upfront and short-listed bidders would be required to specify the annual concession fee they are willing to offer to the Authority. The bidder who offers the highest fee would win the contract. In exceptional cases, instead of offering a premium on concession fee, bidders may seek financial support for meeting their obligations. In such cases, the bidder seeking the lowest grant should win the contract.

## Concession fee

**Concession fee should be levied only if revenue streams can sustain it**

Concession fee will be a fixed sum of Re. 1 per annum for the concession period. Where bidders do not seek any grant and are willing to make a financial offer to the Government, they will be invited to quote a premium on concession fee, which would increase in each subsequent year by an annual rate specified in the MCA. The rationale

for the above fee structure is that in the initial years, debt service obligations would entail substantial outflows. Over the years, however, the Concessionaire will have an increasing surplus in its hands on account of the declining debt service on the one hand and rising revenues on the other. Recognising this cash flow pattern, the concession fee to be paid by the Concessionaire will be on an ascending concession fee.

PPP projects in several sectors rely on revenue sharing between the Concessionaire and the Authority as the basis of bidding and award. In this case, however, the project revenues would be largely commercial in nature, and specifying the precise treatment and computation of these revenues could pose constant difficulties. Moreover, their manner and extent of the collection may not be easily amenable to monitoring. Thus, a fixed annual concession fee is the preferred arrangement.

### **Risk Allocation**

As an underlying principle, risks have been allocated to the parties that are best suited to manage them. Project risks have, therefore, been assigned to the private sector to the extent it is capable to managing them. The transfer of such risks and responsibilities to the private sector would increase the scope of innovation leading to efficiencies in costs and services.

The commercial and technical risks relating to construction, operation and maintenance are being allocated to the Concessionaire, as it is best suited to manage them. Other commercial risks, such as the rate of growth of passenger traffic, have also been allocated to the Concessionaire. The traffic risk, however, is significantly mitigated as the railway station is virtually a monopoly where existing traffic volumes can be measured with reasonable accuracy. On the other hand, all direct and indirect political risks are being assigned to the Government.

**Risk allocation and mitigation is critical to private investment**

It is generally recognised that economic growth will have direct influence on the growth of traffic and that the Concessionaire cannot in any manner manage or control this element. By way of risk mitigation, the MCA provides for extension of the concession period in the event of a lower than expected growth in traffic. Conversely, the concession period is proposed to be reduced if the traffic growth exceeds the expected level.

### **Financial close**

**Project implementation must commence as per agreed timeframe**

Unlike other agreements for private infrastructure projects which neither define a time-frame for achieving financial close, nor specify the penal consequences for failure to do so, the MCA stipulates a time limit of 180 days for achieving financial close (extendable for another 120 days on payment of a penalty), failing which the bid security is liable to be forfeited. By prevalent standards, this is a tight schedule, which is achievable only if all the parameters are well defined and the requisite preparatory work has been undertaken.

The MCA represents a comprehensive framework necessary for enabling financial close within the stipulated period. Adherence to such time schedules will bring in a significant reduction in costs besides ensuring timely provision of the much needed infrastructure. This approach would also address the typical problem of infrastructure projects not achieving financial close for long periods.

### **User fees**

**Fee should be determined with care and precision**

A balanced and precise mechanism for determination of user fees has been specified for the entire concession period since this would be of fundamental importance in estimating the revenue streams of the project and, therefore, its viability. The user fees shall be based on the rates to be notified by the Government prior to inviting bids for the contract.

The Concessionaire shall be entitled to levy and recover fee for use of car park, handling of parcels and entry of visitors at rates specified in Fee notification. Passengers holding a valid travel ticket would be free to use the railway station without payment of fee, but the Government would pay to the Concessionaire a fee for every passenger at the rates specified in the MCA.

### **Construction**

Handing over possession of the required land and obtaining of environmental clearances are being proposed as conditions precedent to be satisfied by the Government before financial close.

The MCA defines the scope of the project with precision in order to enable the Concessionaire to determine its costs and obligations. Additional works may be undertaken within a specified limit, but only if the entire cost thereof is borne by the Government.

Before commencing the collection of fees, the Concessionaire will be required to subject the railway station to specified tests for ensuring compliance with the specifications relating to safety and quality of service for the users.

**Service quality and safety must be ensured**

### **Operation & Maintenance**

Operation and maintenance of the railway station is proposed to be governed by strict standards with a view to ensuring a high level of service for the users, and any violations thereof would attract stiff penalties. In sum, operational performance would be the most important test of service delivery.

**Maintenance standards will be enforced strictly**

All functions relating to operation of trains would remain with the Government. As such, railway tracks, overhead lines, signalling, communications, ticketing and other incidental functions will continue with the Government.

The MCA provides for an elaborate and dynamic mechanism to evaluate and upgrade safety requirements on a continuing basis. The MCA also provides for traffic regulation, security and rescue operations.

### **Right of substitution**

**Lenders will have the right of substitution**

The project assets may not constitute adequate security for lenders. It is the project revenue streams that constitute the mainstay of their security. Lenders would, therefore, require assignment and substitution rights so that the concession can be transferred to another company in the event of failure of the Concessionaire to operate the project successfully. The MCA accordingly provides for such substitution rights.

### **Force majeure**

**Concessionaire will be protected against political actions**

The MCA contains the requisite provisions for dealing with force majeure events. In particular, it affords protection to the Concessionaire against political actions that may have a material adverse effect on the project.

### **Termination**

**Pre-determined termination payments should provide predictability**

In the event of termination, the MCA provides for a compulsory buy-out by the Government, as neither the Concessionaire nor the lenders can use the railway station in any other manner for recovering their investments.

Termination payments have been quantified precisely as compared to the complex formulations in most agreements relating to private infrastructure projects. Political force majeure and defaults by the Government are proposed to qualify for adequate compensatory payments to the Concessionaire and will guard against any discriminatory or arbitrary action by the Government. Further, the project debt would be fully protected by the Government in the event of termination, except for two situations, namely, (a) when termination occurs as a result of default by the

Concessionaire, 90 per cent of the debt will be protected; and (b) in the event of non-political force majeure such as Act of God (normally covered by insurance), 90 per cent of the debt not covered by insurance will be protected. However, no termination payment will be due or payable if the Concessionaire fails to commission the project owing to its own default.

A different method of evaluation has been adopted for the real estate. It will enable a more transparent and predictable valuation of real estate in the event of termination.

### **Monitoring and supervision**

Day-to-day interaction between the Government and the Concessionaire has been kept to the bare minimum by following a ‘hands-off’ approach, and the Government shall be entitled to intervene only in the event of a material default. Checks and balances have, however, been provided for ensuring full accountability of the Concessionaire.

Monitoring and supervision of construction, operation and maintenance is proposed to be undertaken through an Independent Engineer (a qualified firm) that will be selected by the Government through a transparent process. Its independence would provide added comfort to all stakeholders besides improving the efficiency of project implementation. If required, a public sector consulting firm may discharge the functions of the Independent Engineer.

The MCA provides for a transparent procedure to ensure selection of well-reputed statutory auditors, as they would play a critical role in ensuring financial discipline. As a safeguard, the MCA also provides for appointment of additional or concurrent auditors.

**Independent  
supervision is  
essential**

To provide enhanced security to the lenders and greater stability to the project operations, all financial inflows and outflows of the project are proposed to be routed through an escrow account.

### **Support and guarantees by the Government**

**Support and guarantees by Government are essential**

By way of comfort to the lenders, loan assistance from the Government has been stipulated for supporting debt service obligations in the event of a revenue shortfall resulting from political force majeure or default by the Government. Guarantees and/or compensation have also been provided to protect the Concessionaire, though for a limited period, from construction of competing facilities which can upset the revenue streams of the project.

### **Real estate development**

**Real estate can cross-subsidise other expenses**

Provision for development of real estate by the Concessionaire has been made in the MCA. The Concessionaire can grant sub-licences for the real estate and the same would revert to the Government at the end of the concession period.

While allowing sufficient flexibility to the Concessionaire with respect to exploitation of commercial space at this railway station, the MCA stipulates some limits and restrictions to prevent excessive commercialisation.

### **Miscellaneous**

**An effective dispute resolution mechanism is critical**

The MCA addresses other important issues such as dispute resolution, suspension of rights, change in law, insurance, defects liability, indemnity, redressal of public grievances and disclosure of project documents.

### **Conclusion**

**Private participation should improve efficiencies and reduce costs.**

Together with the Schedules, the proposed contractual framework addresses the issues that are likely to arise in financing and operation of railway stations. The proposed

regulatory and policy framework contained in the MCA is a pre-requisite for attracting private investment with improved efficiencies and reduced costs, necessary for accelerating growth.