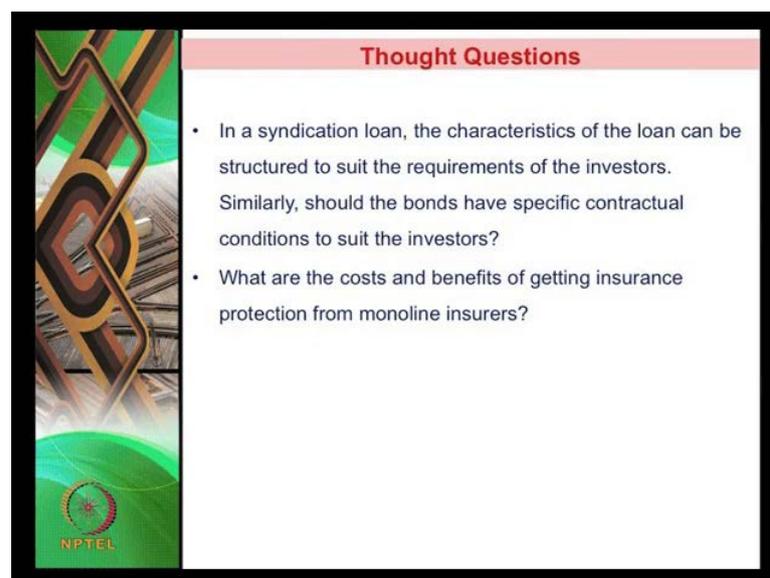


Infrastructure Finance
Prof. A. Thillai Rajan
Department of Management Studies
Indian Institute of Technology, Madras

Lecture - 26
Project Finance Markets - Project Bonds

Welcome back to this course on Infrastructure Finance, this is lecture 26. And in this lecture, we will talk about project finance markets and more specifically we will continue our discussion on project bonds, that we have discussed in the previous lecture. But before we do that, let us quickly spend some time on the thought questions that we had in the previous lecture.

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Thought Questions

- In a syndication loan, the characteristics of the loan can be structured to suit the requirements of the investors. Similarly, should the bonds have specific contractual conditions to suit the investors?
- What are the costs and benefits of getting insurance protection from monoline insurers?

The first question was, in a syndication loan the characteristics of the loan can be structured to suit the requirements of the investors. The question is should the bonds have specific contractual conditions like we have in syndication loans to meet the needs of specific investors. Before we actually look at, what should be the answer for this, we should try and look at the characteristics of these two major sources of debt funding, one is your syndication loan and then your project bonds.

Now, what is a major distinguishing factor between these two, there are several distinguishing factor between these two but then a major distinguishing factor between these two is the possibility of a liquidity in the case of a project bond. In the case of a

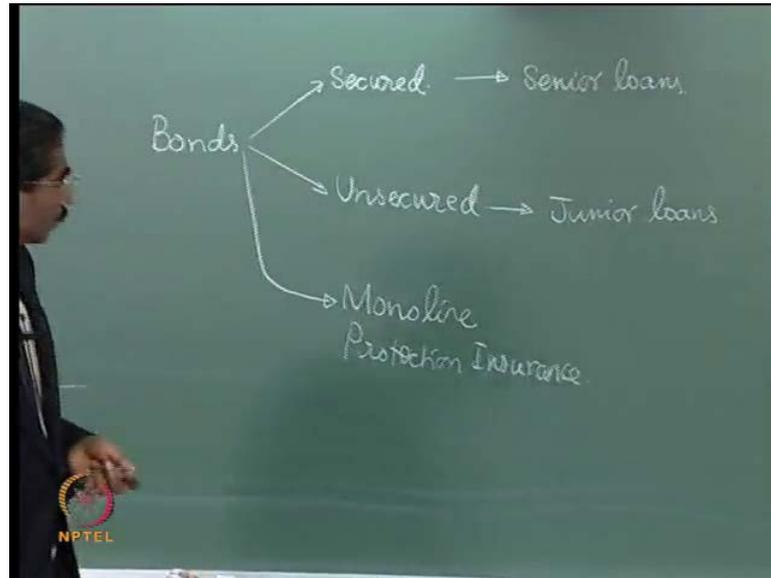
syndication loan, very rarely are the inventors able to exit from the investment before the expiry of the loan. But, in the case of a project loan, there is a possibility of, in fact most often there is a secondary transaction between one investor and the other.

So, this liquidity of the investment is a very important distinguishing feature between a bond and a loan. So, when liquidity is an important feature of the instrument, would specific contractual conditions will promote liquidity or will it hamper liquidity. Now, if are going to actually have some contractual provisions, specific so certain categories of investors, that indicates that, it may not be suitable for another set of investors, because those contractual provisions might not be a value or might not appeal to them.

So, when you actually have more and more detailed structuring, more and more detailed contractual provisions to meet the needs of the investors then the next alternate set of investors, who are going to value those kinds of provisions are going to be very, very small. So, in essence, the market for a secondary scale is going to become lesser and lesser, mainly because finding alternate set of investors, who will actually prefer the same kind of contractual provisions is going to be more and more difficult.

So, therefore, when we actually have specific contractual provisions, that means that, the possibility of the liquidity potential becomes lesser and lesser, more detailed provisions, lesser is the liquidity provision. Now, when people are investing the bond, they are trying to look at the provision of liquidity and when we actually have these kinds of provision, this actually hampers liquidity. So, therefore, the bond should not have very detailed or specific contractual conditions to suit a certain category of investors. The next question is, what are cost and benefits of getting insurance protection from monoline insurance. And before we actually discuss this, we will try and look at, what are the different kinds of protection would investors get from investing in a bond.

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So, if you look at bonds in terms of the various investor protection, there are two categories, one is you have what is called as your secure bonds, so that means, the assets of the project are given as collateral to the investors and the bond issue. The bond is secured by the assets of the project, so the assets could be anything, the assets could be physical assets or the assets could be a contractual arrangements for example, cash flow rights can be part of security given to the lender.

So, there are several types of a secured mechanism that are possible, so that is what, the second is what is called as your unsecured. The second is your unsecured and there are no securities that are actually provided to the to the lenders and the lenders actually have to rely on the cash flows that are available to service the debt flows. In case, the cash flows are not as per predictions then the lenders do not have access to the assets of the project.

So, normally they are classified, the secured are classified as, called as your senior loans and then the unsecured are called as junior loans. So, the senior loans are get paid first and only after the senior loans have been serviced, would the junior loans are get paid. So, this is some kind of a protection, security is a kind of a protection, that the investors enjoy in a secure loan. But, let us say for example, instead of providing any kind of security, let us say the project company takes an insurance.

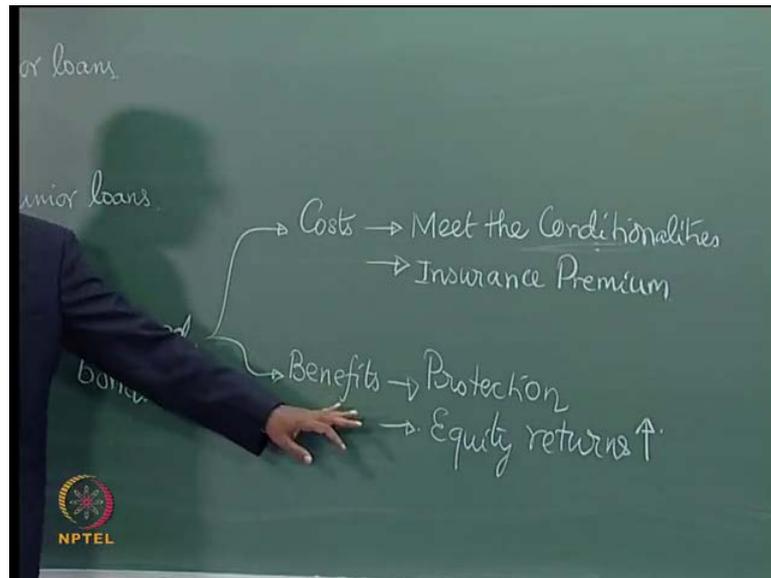
The project company takes an insurance and which ensures that, the investors in the bond issue will be able to get timely repayments of principle and interest, so this is some kind of an insurance cover for the bond. So, we take actually insurance cover for virtually anything, we take an insurance cover for life, we take an insurance cover for health, we take an insurance cover against fire, we take an insurance cover against theft, against the earthquake and what not.

So, similarly, today we have insurance companies, who actually provide an insurance for bond repayment. So, if at all the project company is unable to make the payment on the bonds then the insurance company will make good, the payments to the lenders. So, this an insurance that a project company can take, so this kinds of insurance protection is provided by, what is called as your financial insurance. So, we have what is called as your monoline protection insurance, so this kind of insurance is provided by financial insurers.

So, the insurance companies normally have a very good credit rating, the insurance companies have a triplet A credit rating. And when these insurance companies provide an insurance for the project bonds, naturally the project bonds also get a very high credit rating, because the insurance companies credit rating is actually rubbed off on the project bonds as well. So, naturally, because before we discussed the cost and benefits, this obviously is some kind of protection mechanism for the lenders.

Why this monoline insurance, because this is a kind of an insurance provided typically by financial insurance companies and the financial insurance companies, they do not have other lines of businesses. In fact, their only line of business is to provide financial insurance, so therefore this is called as your monoline insurance. So, this monoline insurance bonds, they are also called as wrapped bonds.

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That is, these bonds are wrapped with an insurance cover around it and that is a reason why, they are denoted by wrapped bonds. Now, the question is, what are the costs and benefits of these kinds of wrapped bonds, what are the costs. So, the cost obviously is, you will have to actually meet the requirements of the insurance in insurance provider and for obtaining the insurance, you will also have to pay the insurance premium.

So, the cost is basically two things, one is to meet the conditionality's of the insurance provider and the second is there would be your insurance premium, the insurance premium needs to be quick. So, these are the two major cost that can be think of and then you actually have benefits, we have the benefits, so what are the benefits of getting these kind of insurance protection to the lenders.

So, the first benefit is, they actually get lot more security, because there is an insurance company, which is providing protection for the payments, so therefore there is a greater amount of a protection as far as the loan repayments are concern. And second is, because of this protection that is provided by the insurance coverage, they are able to raise capital, they are able to raise bonds at a lower rate of interest. So, low interest and when you actually able to raise capital at lower rate of interest then what happens, it obviously increases the equity returns for the sponsors.

So, you have what is called as your equity returns increase for the sponsors, because of the low cost of capital, equity returns increases for the sponsors, so these are the cost and

benefits. Now, we will have to evaluate for a particular case, whether the benefits exceed the cost, if we actually have an insurance premium very large, but we are not able to get substantial reduction and the cost of borrowing then going for a monoline insurance protected bond might not be actually very beneficial.

As long as we are able to get a corresponding benefit that is, more the cost incurred then we can actually go ahead and obtain this monoline insurance. Now, it should also be stated that, this kinds of production facilities is not normally available in all the markets. We can actually see these kinds of wrapped bonds in the US market, but availability of these kinds of products in other markets are a very minimum. It is going to take some time, only as the markets and the institution evolve, such kinds of advance products will come to many other developing countries as well.

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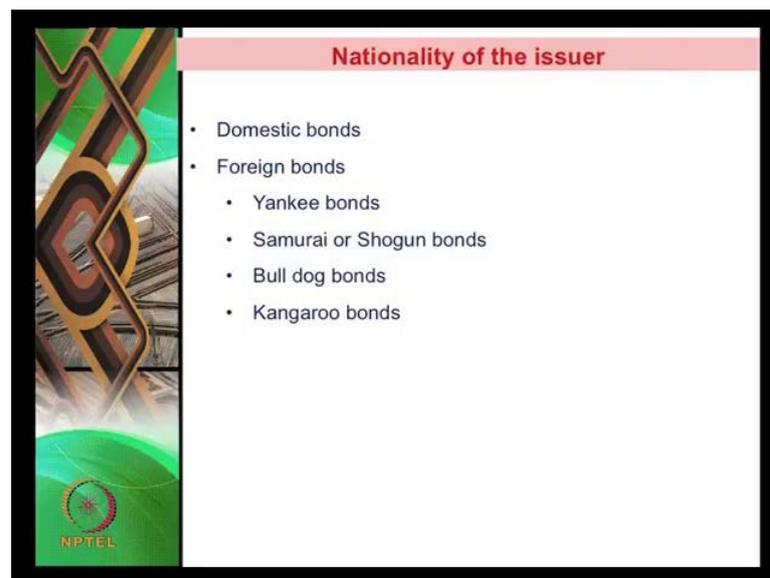


Now, we will go to the topic of today's lecture, which is to actually look at some elements of project bonds that we could not discuss in detail in the previous lecture. So, earlier if you look at it, we said project bonds can be categorized across many dimensions. So, you can actually look at in the nationality of the issue, where you can actually target, you can actually categories based on, who the investors are in the project bond.

We can also categories in terms of the existence of guarantees, you can look at categorizing in terms subordination classes, you can look at categorizing in terms of

interest and capital repayment and so on and so forth. So, there are different categories, in which you can classify, we discussed some aspects of this categorization in the previous lecture. We will look at some additional aspects to some of this categorization in this lecture.

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The first is, we have talk about the nationality of the issuer, so you have broadly two categories, one is your domestic bond and your foreign bond. Domestic bond is, let us say if the issuer issues a bond in the country, in which he is operating then it becomes a domestic bond. Let us say for example, we look at the example of national thermal power corporation in the beginning of this course. Let us say, if national thermal power corporation comes out with a project bond and if this project bond is being issued in Indian market then it becomes a domestic bond.

If it is targeted at getting money from investors within India, it becomes a domestic bond. Now, if the same company, if NTPC starts issuing a bond and if it raises capital from the US market, it is in the dollar, if it is raising a dollar loan then it becomes a foreign bond. If you look at the foreign bond, foreign bonds can be classified into, I know there are different types depending on, which foreign market we are actually raising the loan.

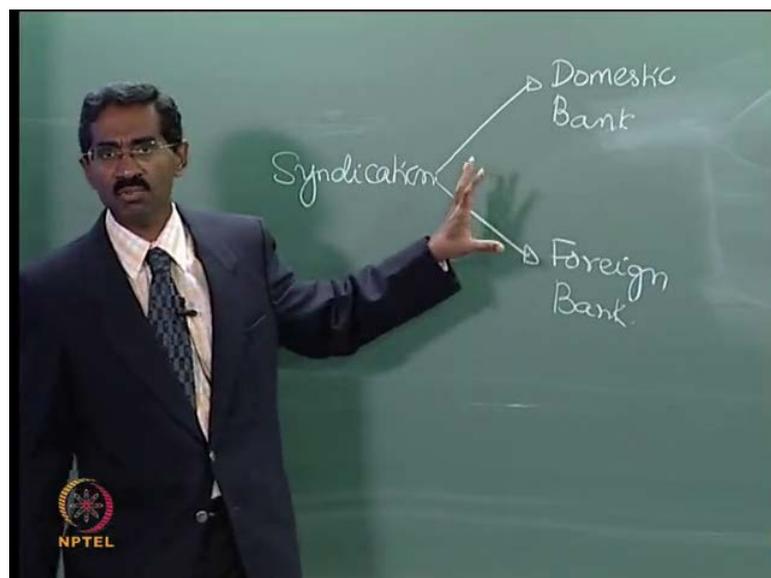
So for example, if the bonds are being raised in the US market that is, a non resident US borrower raising dollar capital in the US market, it is called as Yankee bonds. So, if

Yankee PC comes out with this bond issue and raising dollars in the US market, it is called as the Yankee bonds. But, if it raises money in the Japanese market, it is called as the samurai bonds or the shogun bonds. Similarly, if it raises money in the UK market, it becomes a bulldog bond, if it raises money in the Australian market, it becomes a kangaroo bond.

So, all of them are varieties of foreign bonds, but just that it is a name differently to indicate the currency, which the capital is being raised. So, the question is, when do we actually go for domestic bond and when do we actually go for a foreign bond. So, we have discussed this aspect previously as well, when you try and raise capital from overseas, it actually results in many cases a lower interest rate. But then there are lot of other additional cost that are incurred, but most importantly the decision has to go for domestic or foreign depends on, the amount of capital that needs to be raised.

If it is a domestic bond, domestic bond actually has limitation in terms of the size then people normally go and approach foreign markets as well. So, that is the main reason between, the size of capital that needs to be raised is the main reason for looking at raising money from a foreign markets as well. Now, how is the capital raised in syndication as compared to a bond.

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So, in a syndication if you look at it, in a syndication, a syndication can have many banks, so in the same syndication, you actually have a domestic bank as well as your

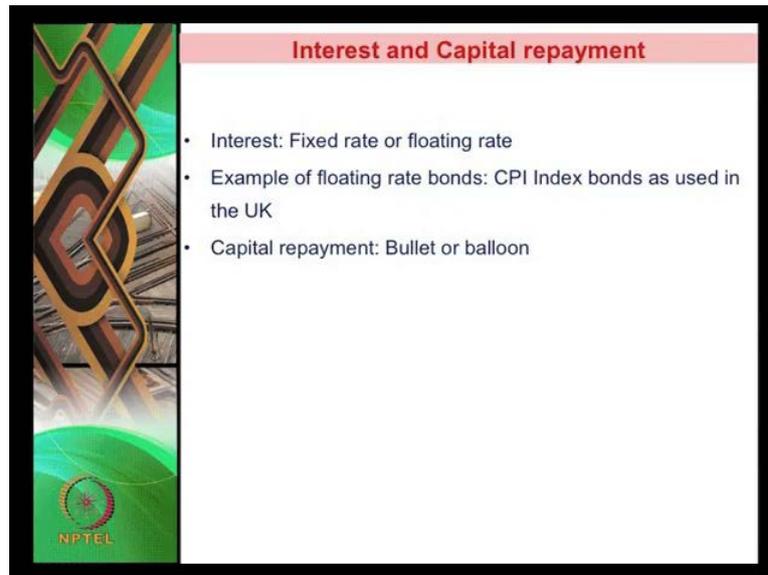
foreign bank. So, the lead arranger is responsible for putting together the syndication of partners and in the same syndicate, you can actually have a domestic bank, you can have foreign bank. You can have actually have all the investors, who are planning to invest in the project.

But, in the case of a bond issue, we need to actually have a separate bond issue for the domestic market, we need to actually have a separate bond issue for the foreign market. So, it cannot be on the same bond issue, we cannot actually have both foreign and domestic investors participating in a single bond issue. The reason is, the regulations and the complaints requirements are different in different markets. The complaints requirements in the Indian markets are different, as compared to the complaints requirements in the US market.

So, therefore, when you actually raising bond in a particular market, you will have to ensure that, you comply with the rules and regulations of the respective markets. So, therefore, if you are raising money in multiple markets, each one of it become a separate issue, each one of them becomes a separate bond issue. If you are raising a kangaroo bond for the same project, you have to come out of the separate issue.

If are raising a Yankee bond it is a separate issue, if you are raising a domestic bond it is a separate issue, all of them could be for the same project but then you will have to raise it all separately. So, that is becomes an additional cost this becomes an additional effort and this needs to be taken into consideration one, deciding on what kind of capital to issue.

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The slide features a decorative graphic on the left side consisting of overlapping, stylized geometric shapes in shades of green and gold. At the bottom of this graphic is the NPTEL logo, which includes a circular emblem with a star and the text 'NPTEL' below it. The main content of the slide is a list of bullet points under the heading 'Interest and Capital repayment'.

- Interest: Fixed rate or floating rate
- Example of floating rate bonds: CPI Index bonds as used in the UK
- Capital repayment: Bullet or balloon

The next is categorizing the bonds in terms of the interest and capital repayment, interest again in normally it can be of two types, one is your fixed rate and the floating rate. So, normally if you look at bonds, the bonds actually have a fixed rate of interest. As compared to syndication, where the loans are normally on a floating rate basis, which are benchmark to a particular benchmark like laybond. So, the question is, when you actually having bonds, which are of a very long term nature, bonds have let us say for example, 10 year term, 20 year term and so on.

So, when you actually having bonds which for such a long tenure, fixing the interest rate actually presents a lot of risk to the investors. Now, how it is possible to predict, what the inflation and what the other parameters are going to be like, 10 years from now. So, if the inflation rate becomes very high then the investors in the bond who are investing today at lower levels of inflation, might be adversely affected. So, today in order to protect the investors of this bond against these kinds of macroeconomic developments, they are trying to provide some adjustments.

So that, the investor's interest are protected for any increase in inflation and currency conversions and so on and so forth. So, you have elements of a floating rate being incorporated in the bonds as well, one example of these kinds of floating rate bonds is, what is called as your CPI index bonds. So, this is CPI is your Consumer Price Index and changes in the consumer price index is seen as an indication of underlying inflation. So,

as the changes in inflation are reflected in the CPI index and the CPI index is used as the benchmark to determine, what is going to be the interest on the bond issue.

Now, this is not something that has been commonly used in many markets, this example of CPI index bond is been used in UK, but what I am trying to illustrate here is that, we can actually see examples of floating rates being used in the bonds as well, this is not something that is actually used in the syndication rules. Next we talk about capital repayment, whether it is going to be gradually throughout the loan period or is it going to be one shot at the end of the loan.

So, normally if it is one shot at the end of the loan period, it is called as a bullet repayment. And if it is increasing through the loan term that is, it starts at the very small amount, but as the loan progresses towards majority, if the capital repayment increases then it is called as your balloon repayment. So, what should be the kind of repayment in a project loan, so now, let us compare a project bond vis-a-vis traditional bond, which we call let us say, a corporate bond.

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So, bonds in terms of generic types, let us say we classify them as corporate bond and we classify them as project bond. So, whatever we have been discussing so far has been on project bonds, but there is been other category called corporate bonds, where the bonds are issued by the corporations and this is something that is used in corporate finance. So,

when you talking about bullet repayment, how does the bullet repayment happen, bullet repayment means, the entire principle is repaid on majority.

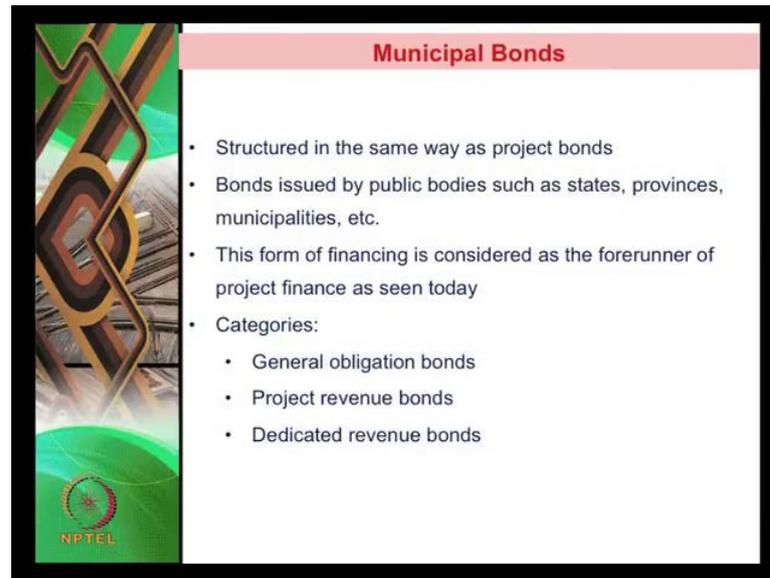
So, when the entire repayment is paid on majority, the only way it happens is, when there is a refinancing. The borrower refinances the current loan and it uses the proceeds from the new investors to pay up the existing investors, so this bullet repayment can actually happen only under those circumstances. Now, a bullet repayment is possible for a corporate financing scenario, because we are actually having a situation, where corporation is the going concern, the corporation is going to function forever.

So, therefore, the assets of the corporation can be financed on an ongoing basis, but if you look at a project finance company, a project finance company does not really function as an ongoing concern, because of the limited period of the license, the concession period is usually for 20 year period or 30 year period and so on. So, therefore, one is better off to actually repay the principle in project finance loan on an ongoing basis, as compared to a bullet payment.

Because, the possibility of refinancing at the end of the project life might not actually happen, simply because of the fact that, the project might cease to exist at the end of the concession period. So, their possibility of refinancing is going to be difficult, as in the concession period ends. So, therefore, the lenders would actually be better off, if the capital is being repaid on a periodic basis, rather than a bullet in case of a project finance loan.

Now, there are exceptions of course, when there is a refinancing at the end of a construction period then obviously, the project finance company will do a bullet repayment. But, we are talking about a bond repayment, when we are talking about a bond repayment, it is better off being paid over the loan term, rather than as a bullet repayment.

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The slide features a decorative background on the left with green and gold geometric patterns and the NPTEL logo. The main content is a list of bullet points under the heading 'Municipal Bonds'.

- Structured in the same way as project bonds
- Bonds issued by public bodies such as states, provinces, municipalities, etc.
- This form of financing is considered as the forerunner of project finance as seen today
- Categories:
 - General obligation bonds
 - Project revenue bonds
 - Dedicated revenue bonds

Next we discuss about a special category of bond called as the municipal bonds, so municipal bonds are not really project financed bonds, but why we are trying to discuss it here, because these municipal bonds are structured in the same way as the project bonds. Now, what are these municipal bonds, project bonds are those that are issued by a project company, similarly municipal bonds are those that are issued by public bodies.

So, for example, state governments, provinces and municipalities, other arms of a local government, whenever they actually issue bonds and raise capital for their projects, they are called as your municipal bonds. In fact, the municipal bonds financing is considered as a foreign of project finance as seen today, it all started probably in the united states in the 1980s when a municipalities started issuing bonds to raise capital for infrastructure projects that are being developed in the respective cities.

And in those days, private financing of infrastructure was not very common, but they were trying to utilize as many innovative ways of funding these large projects. And that is, when municipalities realized that, they can use their strength of their operations to raise capital to fund the infrastructure projects. So, some of these municipal bonds has been very successful and generally, if you look at it, these municipality bonds can be categorized into three categories.

The first is your general obligation bonds that is, the municipalities will service the investors based upon the overall strength and the operations of the municipal

corporation. It is not specific to any particular project and so on, it is a overall obligation of the municipality to pay the investors in the bond. And the next is your project revenue bonds, project revenue bonds are those bonds, where the bonds are going to be serviced from the cash flows of the particular project.

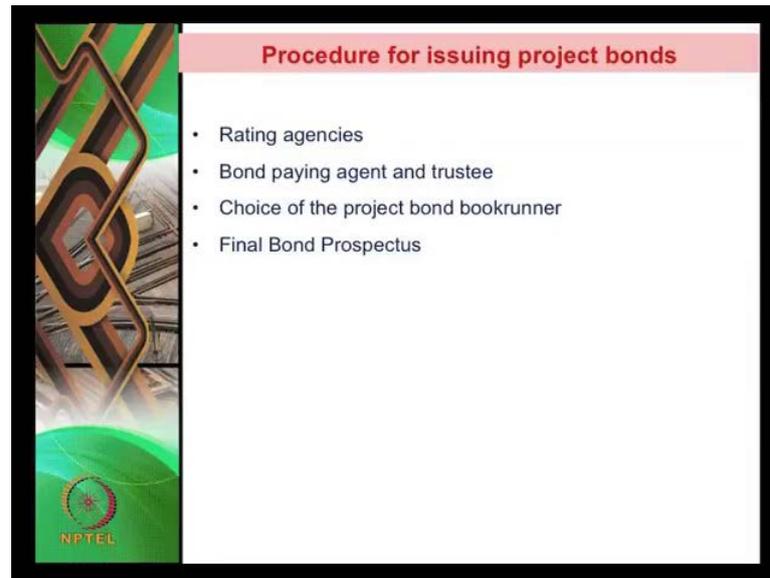
So, it is very different from a general obligation bonds, so if the cash flows of a particular project do not really, if there is a short fall then obviously, the investors in those kinds of bonds will have to suffer. Then you have the third called as your dedicated revenue bonds, a dedicated revenue bonds indicate that, the certain dedicated revenue sources of the municipality are pulled and then the cash flows of those dedicated sources are used to service the investors of the bond.

So, there could be many dedicated revenue sources for the municipality, let us say for example, the municipality levies parking charges on roads. So, again this parking fees can be one form of cash flow, the other form of cash flows could be rental revenues. Let us say, the municipalities has some buildings and the buildings are been leased out at various occupants and then the rental income provided by these different occupants can be a source of revenues.

And the municipalities could provide different forms of services and then the income from these different forms of services could be another source of revenue. The municipalities could actually levy some local taxes such as, the property tax and so on. So, again the cash flows from these kinds of taxes can be a dedicated revenue sources, there can be several different dedicated revenue source and then one can identify a specific revenue streams and these revenue streams can be dedicated to the investors in the particular bond issue.

The cash flows from these dedicated revenues streams can be used to service the inventors in the bond issue. So, there are different types categories, so the project revenue bonds that we see is very similar to the project bonds that we actually have today, except in this case it is being issued by the municipality. But, the project bonds that we see today is been issued by private corporations, not private corporations, but the specific project companies to finance their projects.

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Now, let us spend some time discussing the procedure for issuing project bonds, when you really look at procedure, there are four main parts of it. The first is, getting a rating for the proposed bond and the second is, in terms of identifying the bond paying agent and the trustee, and the third is identifying the project bond bookrunner and the finally, preparing the final bond prospectus. The most important aspect in project bond is, to actually get a correct reading of the bond.

So, why do we actually have to go for a credit rating, we actually have to go for a credit rating, because people who are investing in the bond might not be well acute to understand and evaluate on the various risks, that exists in the investment opportunity. So, therefore, that the bond issue has to be evaluated and upraised by well knowledgeable person so that, the investors who are investing will actually have a good understanding of the prevailing risk of this investment opportunity.

So, that is the objective of doing credit rating, investors if they invest without properly understanding the risk then if they are not able to recover the investment then subsequently they will not be prepared to invest mean, in additional issue and this can actually result in collapse of the financial market. So, to safeguard the interest of the investors and to prevent these kind of a market collapse, credit rating is being mandated. So, today it is must, it is a part of our regulatory requirement, that the bonds will have to be credit rated before they can be issued in the market place.

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The slide is titled "Rating agencies" in a red header. On the left side, there is a vertical graphic with a green background, featuring a stylized orange and brown geometric pattern and the NPTEL logo at the bottom. The main content is a bulleted list:

- Credit rating agencies – S&P, Moody's, Fitch
- In India – CRISIL, ICRA, CARE
- Rating refers to the issuers' intention and ability to repay its debts punctually
- Ratings
 - Investment grade – Bonds having a limited risk of insolvency
 - Speculative grade – Bonds with an increasing risk of insolvency up to actual default

So, there are different types of credit rating agencies, universally there are three major credit rating agencies, the standard and poor's commonly denoted as S and P then we have Moody's and then you have Fitch. In India, they operate through their subsidiary companies for example, you have CRISIL, which is essentially a part of the S and P global, which provides credit rating agencies, similarly you have ICRA, similarly you have CARE, which essentially are subsidiaries of the global credit rating agencies.

So, rating, what does rating mean, rating generally refers to the issuers intention and the ability to repay it is debts punctually. So, if a rating is of a particular type then an investor gets an understanding, based on the credit agencies and appraisal of the project on the goodness of the investment. So, their ratings can be broadly different two categories, you actually have investment rate, so bonds which have a limited risk of insolvency.

So, ultimately we have to understand that, it is not that these instruments are risk free, even an investment grade bond will have a certain amount of risk, but the risk is limited. Now, we look at the second category of rating, which is called as a speculative grade, so in the speculative grade bond, there is an increasing risk of insolvency and even actual default. So, there is a possibility, that the investors are not paid by the borrower and this possibility is higher in a speculative grade as compare to an investment grade.

So, a rating once issued is not going to be static and as the company's business situation changes, the rating can also change. So, for an example, an investment grade bond can over period of time, become a speculative grade, if the conditions so happen in the market.

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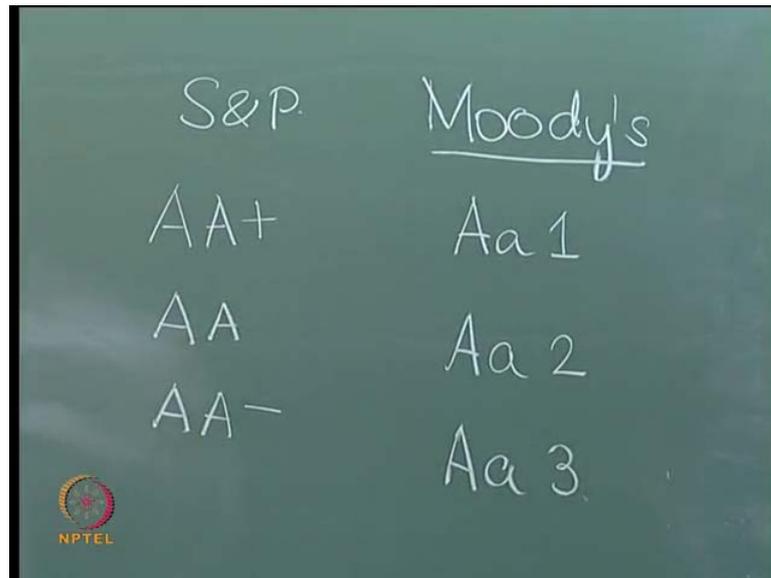
Rating Scales		
	S&P	Moody's
Investment grade	AAA	Aaa
	AA	Aa
	A	A
	BBB	Baa
Speculative grade	BB	Ba
	B	B
	CCC	Caa
	CC	Ca
	C	C
	D	



So, this are the different types of rating scales that we normally have, I have given you examples of S and P, and Moody's rating scale. So, if we look at S and P, the investment grade rating start from triple B and in the case of Moody's, the investment grade grating starts from B double A. And then the highest investment in S and P is triple A and in Moody's, it is again triple A but then it is denoted as capitol A and then small a. So, you actually have different investment grade ratings then you also have speculative grade ratings.

So, speculative rating starts from double B and goes all the way down to D in the case of S and P, whereas in the case of Moody's, it starts at B A and then goes all the way down to C. So, usually what happens, there are also grades at different level.

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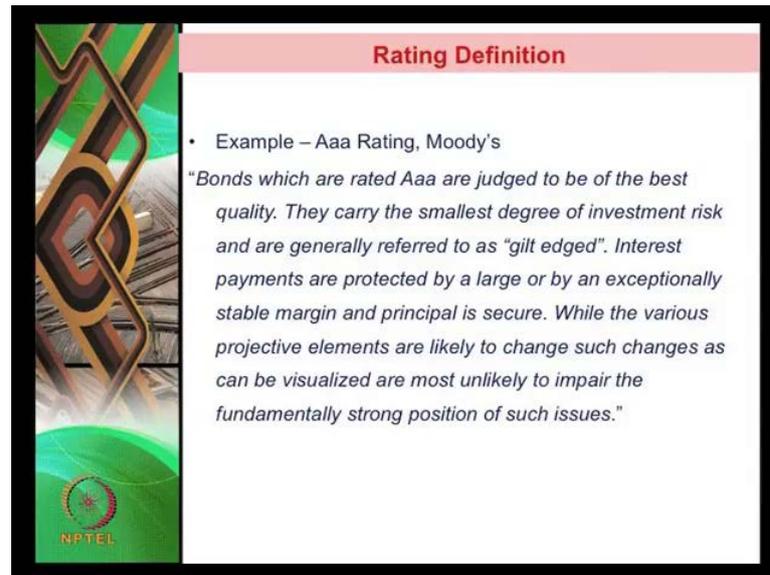


S&P	Moody's
AA+	Aa 1
AA	Aa 2
AA-	Aa 3

So, for example, you have in S and P, so you have double A but then to differentiate between different issues with double A rating, there is a definition that is differentiated by double A plus, double A and then you have double A minus. So, double A is differentiated into three different notches, double A plus, double A and double A minus. Whereas, in the case of Moody's, it is denoted by numbers 1, 2 and 3, so double A is A a 1 then it is A a 2 then it is A a 3.

So, it is just a question of terminology and how the ratings are given by the different rating agencies. But, all sudden then if you look at it, there is no multiple levels for triple A rating in the both S and P and Moody's. So, there is only one triple A, there is no triple A plus, there is no triple A minus. So, triple A is the highest form of investment grade rating and within that, there is no differentiation.

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Rating Definition

- Example – Aaa Rating, Moody's

"Bonds which are rated Aaa are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as "gilt edged". Interest payments are protected by a large or by an exceptionally stable margin and principal is secure. While the various projective elements are likely to change such changes as can be visualized are most unlikely to impair the fundamentally strong position of such issues."

Let us look at rating definition for example, I have given here the rating definition that is given by Moody's of the triple A rated bond. So, a definition for a triple A rated bond is as follows, so Moody's states that, bonds which are rated triple A are judged to be of the best quality. So, in terms of, what you mean by quality, it is listed later, but the top line states that, bonds related triple A are judged to be of the best quality.

They carry the smallest degree of investment risk, so clearly indicates that, there is some amount of risk, but the risk is small, it does not say that, there is no investment risk, there is a degree of investment risk. And they are generally referred to as guilt edge, guilt edge indicates that, they are very, very good investment opportunities with very, very limited chances of default, so refer to as guilt edge. The definition continues, interest payments are protected by a large or by an exceptionally stable margin.

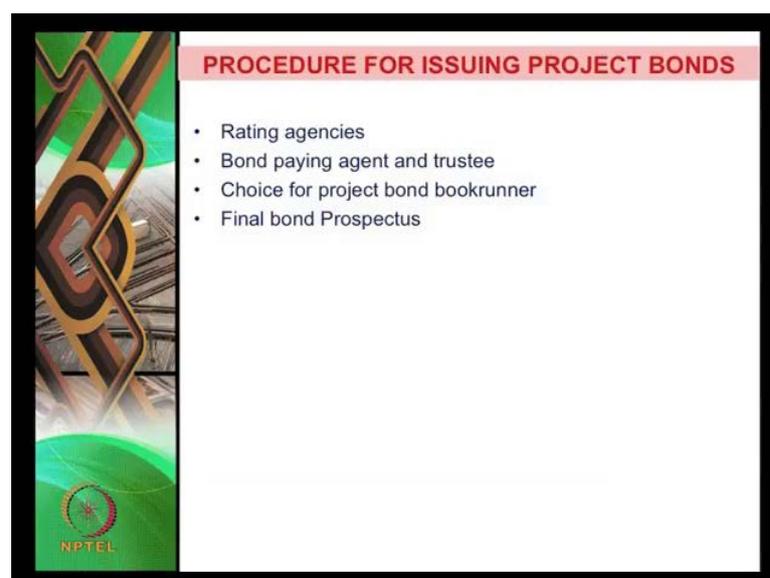
See for example, only when the company or the projects gets adequate margins, will they be able to service the interest. There has to be some level of surplus, surplus in terms of operating cash flows for them to actually service the interest, so protected by a large. So, if the operating margins are large or stable, both, it has to be large and it also has to be stable. And when the principle is secure, when you say secure, principle is secure by some assets, while the various products are likely to change, such changes can be visualized or most unlikely to impact the fundamentally strong position of such issues.

So, there can be changes in the micro environment, but such changes are unlikely to impact the strong fundamental of this triple A issue, so this is the definition of a triple A issue of Moody. Now, let us look at, let us say a definition for B A rating, B A rating is not an investment grade, B A rating is a speculative grade rating. So, the definition for a B A rating is, bonds which are rated B A, are judged to have speculative elements.

Speculative elements in the sense that, where the risk is very high, there is a possibility that your investment might be defaulted, their future cannot be considered as well assured. The interest and principle repayments may not happen on time, may be defaulted, so that is the meaning of cannot be considered as well assured. Often the protection of interest and principle repayments may be very moderate for example, in a triple A rating, we had a very large and stable margins.

Whereas in this case, the interest and principle payments, the protection to this may be very moderate, may not be as strong as we have seen in triple A rating, and thereby not well safeguarded during both good and bad times. Things can change not only in bad times, but even in good times as well, because the protection is not very strong. Uncertainly, your position characterizes bonds in this class, so there is uncertainty and bonds with B A rating are characterized by these kinds of uncertainty. So, this is the definition for a B A rating.

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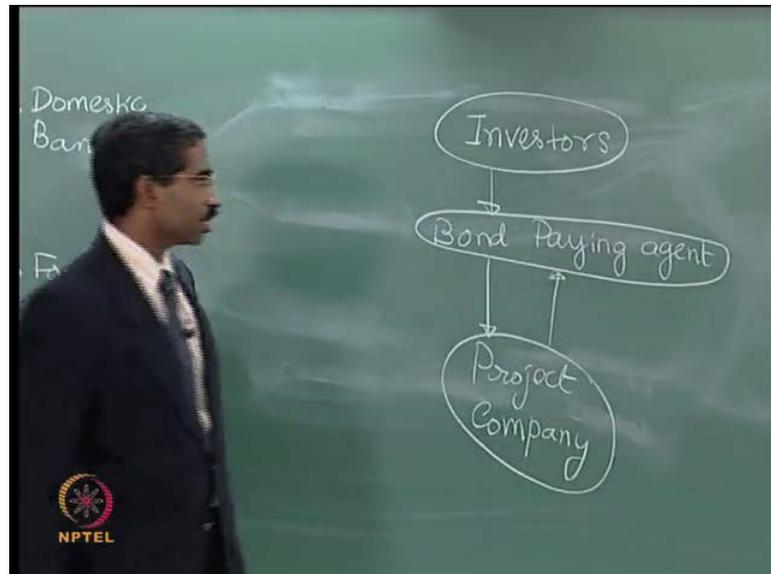
PROCEDURE FOR ISSUING PROJECT BONDS

- Rating agencies
- Bond paying agent and trustee
- Choice for project bond bookrunner
- Final bond Prospectus

NPTEL

Next we will look at the other players in the procedure, we talked about bond paying agent and the trustee.

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So, normally when the investors subscribe, so you have the investors in the bond and then you have the project company, the project company which is issuing the bond. So, normally when the investors subscribe to the issue, the money does not directly go to the project company. So, you have, what is called as your bond paying agent, so the money subscribed by the investors goes to the bond paying agent and the bond paying agent in turn, releases the money to the project company.

So, the bond paying agent acts as some kind of a gatekeeper between the investors and the project company. Similarly, when the project company repays a principle as well as interest, the project company goes, the cash flow stream go to the bond paying agent and the bond paying agent in turn, provides the inventors. So, bond paying agent essentially takes the administrative task of repayment and administrative task of collecting the loan amount and giving it to the project company, it is more in the case of an administrative agent.

A project finance company by outsourcing this administrative responsibility, is able to focus on managing the project better, rather than ensuring that, whether the interest are reaching the investors on time, whether the address and other details of the investors are correct in his books of records and so on and so forth. And then you also have another

important player called as trustee, so trustee is an entity that represents the interest of the investors.

For example, there could be several conveyance associated with the bonds, so the trustee will ensure that, the project company is complying with the various governance and the contractual requirements that are stated in the bond. So, trustee, there are so many investors and if all the investors are actually trying to monitor the company then it is actually going to be a very difficult for project company to focus on the operations.

On the other hand, many of the investors might be small scale investors, they may not really have the ((Refer Time: 43:17)) or expertise to monitor, this when actually result in, what is called as a free radar problem. So, to ensure all of these problems are avoided, the investors have a trustee arrangement and the trustee is responsible for ensuring that, all the contractual governance and commitments stated in the bond issue are adhere to by the project company.

In essence, if there is any security that are associated with the bond issue then the trustee hold on the security on behalf of the investors. So, trustees are somebody who have, who represent the interest of the investors, but at the same time, they do not have the right to take decisions independently. Any decisions that needs to be taken, the trustee will have to convene a meeting of all the investors and then the investors will have to take a decision, which will again be conveyed to the trustees, which in turn will conveyed to the project company.

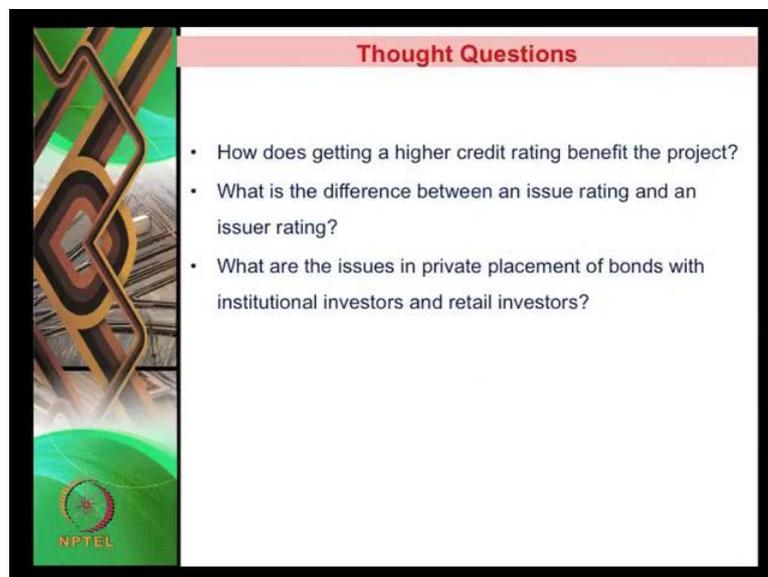
So, though the trustees are responsible for the interest, you know it is very important to understand that, they do not have any decision making rights on their own. Then the third necessary choice of project bond bookrunner, so project bond bookrunner, the role of the project bond bookrunner is very similar to that of, what you see in the case of an arranger in the syndication loan.

So, the leach that the project bond bookrunner is responsible for ensuring that, the bond is marketed to different investors. He is responsible for ensuring that, the entire capital as envisage is raised from different investors and so on. So, he is responsible for the road shows, he is responsible for generating interest among different investors on the bond issue and so on. Basically, the role of the advisor, investment banking, that we see in the

case of syndication loan is performed by the project bond bookrunner, in the case of a bond issue.

And then there is this final bond prospectus that needs to be prepared, the final bond prospectus provides the various information on bond price, it talks about the term of the bond, it talks about the potential rates, yield rates and it takes about the various conveyance and so on. So, the final bond prospectus needs to be prepared, which then will be used to market the bond, so this is the broad procedure for issuing project bonds.

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Thought Questions

- How does getting a higher credit rating benefit the project?
- What is the difference between an issue rating and an issuer rating?
- What are the issues in private placement of bonds with institutional investors and retail investors?

Now, let us go to the thought question for today's lecture, actually have three questions, the first question is, we taught about different types of credit rating, how does getting a higher credit rating benefit the project. For example, you have triple A rating and then you have rating of D, which is a speculative grade rating. If a project bond gets a higher credit rating, hoe does it benefit the project. The second question is, what is the difference between an issue rating and an issuer rating.

So, when we talk about rating, either you can rate a particular issue, I can rate a particular bond issue or you can actually rate a company that is issuing the bond, so we just trying to see, is there a difference between an issue rating and an issuer rating. The third question is, targeting the investors for a particular bond, should we actually target qualified institutional investors or should it be at the retail investors.

In essence, should we actually place the bond on a private placement basis or should the bond be marketed at the retail investors, what are the advantages and disadvantages of both. So, try and think through these questions and we will discuss it in the next lecture.