RBI’s Project Financing Guidelines

Mains syllabus: GS3 – Indian Economy and issues relating to planning, mobilization, of resources, growth, development and employment.

Why in news?

Recently, RBI (Reserve Bank of India) changed its project financing rules.

What are the stages of a project?

- In the context of RBI’s project financing, a project goes through three phases, namely, the design phase, the construction phase, and the operational phase.
- **Design phase** – This typically includes planning and conceptualization which includes preparing a project proposal, then reviewing its potential risk analysis, identifying the potential lenders.
- **Construction phase** – It involves execution and building of the plan and so the project do not generate any revenue in this phase.
- Loan disbursement occur in a phased manner throughout the phase by means of mobilizing resources, delays, unforeseen expenditure, supply shortages.
- **Operational phase** – Once after completing phase 2, it starts to operate and generate revenue by means of production.

What are the RBI's guidelines?

- **Provisioning Requirement** - The Reserve Bank of India’s (RBI’s) recent project financing guidelines have emphasized that the provisioning requirement on project finance is now 1 %, instead of 5 % proposed earlier.

Provisioning requirement *means capital that kept by the banks to deal with the future risks against loans.*

- **Land and Right of Way Requirement** - A lender shall ensure availability of sufficient land/right of way for all projects before disbursement of funds, subject to following requirements
  - For infrastructure projects under PPP model – 50%
  - For all other projects (non-PPP infrastructure, and non-infrastructure including CRE & CRE-RH) – 75%
  - For transmission line projects – as decided by a lender.

Right of way *is a legal right to use another person's land for a specific purpose, like a road or utility line.*

- **DCCO Deferment Limits** - Permitted DCCO deferment limits under the guidelines are
  - For infrastructural projects – Covering 3years from original DCCO.
  - For non-infrastructural projects – upto 2 years.
- Cost overruns up to 10% due to DCCO extensions as stated above may be funded by lenders through pre-approved **Standby Credit Facilities** (SBCF).

What is DCCO?
• **DCCO -** It means Date of Commencement of Commercial Operations, is the target date for operations. • DCCO can be delayed because of any unforeseen situations like supply shortages like lack of raw material for the production. - **For example** - if China and India is in war, if the supply of rare earth minerals export is paused for India by China, leads to delay project functioning.

What are potential benefits of the updated norms?

- **Increases in Capital Availability** - New guidelines eased the risk of excess absorption of capital and avoided slowdown in the economic activity.
- **Maximizes loan recovery chances** - As projects can gather required resources, they generate more profits and repays loan to banks fully.
- **Avoids premature liquidation** - Provides a lucrative opportunity for the projects and avoiding premature liquidation.
- **Boosts employment and economic growth** - By increasing production, these reforms facilitate economic growth , income and overall demand in economy.

Why blanket extension of DCCO is disruptive?

- Even it seems compassionate and helpful blanket extension of the DCCO is considered disruptive for the several reasons.
- **Advocate Mismanagement** – Delays due to poor leadership and corruption leads to further reduction in performance.
- **Increase in Asset Devaluation risks** – Blanket extensions will prevent opportunity costs of liquidation of assets, which can function very well individually.
- **Capital depreciation** – A power plant delayed for years might see its *machinery depreciate* or become outdated by the time it starts operations.
- **Distorts healthy competition** – Projects with serious issues would be getting unfair advantages over projects that are timely and well-managed.
- In some cases, borrowers may even steal assets pledged to the banks. Even social welfare is likely to be enhanced if the assets are passed on to a more efficient user of capital through bankruptcy or liquidation proceedings.

What are challenges associated with new rules?

- **Create volatility** - In the long run excess credit availability may create volatility in the project functioning, if poorly managed.
- **Asset quality deterioration -** If project delays, cost increases, early stress fall on asset's functioning, leads to asset quality reduction.
- **Loan Default** - Failure meeting loan repayment obligations on time by the barrowers.

- **Risk of NPA Classification** - Delayed projects will be classified as NPA (Non-Performing assets) by the banks.
- **Affects Banks Financial Position** -Banks will be left with reduced capital for the new lending.
- **Reduction in investor confidence** - Due to delay in functioning and generating profits, investors may be hesitant to invest in the projects.

What lies ahead?

- Lenders can be asked to have a board-approved policy of identifying liquidity shocks and establish a process where the DCCO may be extended only when they are convinced that the delay is due to such shocks.
- RBI in its part, may review lender policy, make it advantageous to the best users of the capital to maximize production and employment.
- Banks can be linked with real-time project managing dashboards by using drone technology and timely updates of the projects.
- With involving multi stakeholders, quick Licensing and project approvals can be ensured at every stage to avoid in delays.

References

Business Standard | RBI’s Project Financing Guidelines

Reserve Bank of India (Project Finance) Directions, 2025