

RATING METHODOLOGY - INFRASTRUCTURE INVESTMENT TRUSTS (InvITs) August 2023



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This rating methodology describes ICRA's approach to assessing the credit risk of Infrastructure Investment Trusts (InvITs), and supersedes ICRA's earlier methodology document on this subject, published in March 2022. While this revised version incorporates a few modifications, ICRA's overall approach to rating InvITs remains materially similar.

This rating methodology aims to help issuers, investors and other interested market participants understand ICRA's approach to analyse risks that are likely to affect rating outcomes. This document does not include an exhaustive discussion of all the rating factors that our analysis considers but provides an overall perspective of the considerations that are usually the most important.

Overview

Infrastructure development is the key to long-term sustainable economic growth of any country. Given the long gestation period, infrastructure needs long-term capital. However, currently a bulk of India's infrastructure funding needs are met by the domestic commercial banks who are constrained to provide such long-term funding in view of asset-liability mismatches. To overcome this, banks invariably compress the repayments to a shorter tenor of 10-12 years (against a desired loan tenor of 20 years), thereby resulting in higher annual debt servicing obligations. With this, not only does the debt servicing capability of the project gets strained, but the project's ability to generate surpluses out of internal generation gets constrained. The regulations around InvITs were introduced by the Securities and Exchange Board of India (SEBI) to enable the channelling of long-term capital into the infrastructure sector. This is achieved by way of acquisition of assets housed under special purpose vehicles (SPVs) by a SEBI-registered InvIT, which in turn issues units to the investors. This mechanism enables the release of the developers' capital invested in the SPVs, which can then be deployed into new projects. InvITs look to tap the patient investor class, including pension funds, insurance companies and sovereign wealth funds that tend to have a longer investment horizon.

About InvITs

The InvITs are collective investment vehicles that enable developers of infrastructure assets (generally held under various SPVs) to monetise their assets by pooling multiple assets under a single entity (trust). In India, InvITs are governed by the SEBI (Infrastructure Investment Trusts) Regulations, 2014 and its subsequent amendments (last amended on February 14, 2023). The key features¹ of InvITs are mandatory distribution of 90% of net distributable cash flows (NDCF)² to the unit investors, a leverage³ restriction of 49% on the net asset value (which can be increased to 70% subject to certain conditions⁴), and a limit of investment in under-construction infrastructure projects at 10% of the value of InvIT assets (for publicly-listed InvITs). The InvIT sponsor is responsible for setting up the InvIT and appointing the trustee. The sponsor should hold a minimum 15% of the units issued by the InvIT with a lock-in period of three years from the date of issuance. Credit rating is mandatory for InvITs if the aggregate consolidated borrowings and deferred payment obligations of the InvIT (including that of holding company, and the SPVs) net of cash and cash equivalents exceed 25% of the value of the InvIT assets.

What does the credit rating of InvITs address?

The credit rating of an InvIT is an opinion on its ability to service its debt obligations in a timely manner. The credit rating assessment involves evaluating the predictability and adequacy of the InvIT's cash flows to service the external debt, while assessing the operational and financial risk profile of the InvIT's portfolio of assets. The rating factors in the consolidated external debt availed/ proposed to be availed by the InvIT and its constituent portfolio of SPVs (i.e., the committed liabilities), and contingent liabilities, if any. If the InvIT acquires new assets or raises additional debt, post rating, ICRA will, at that juncture, evaluate the impact of these on the rating.

The InvIT's credit rating is not a reflection of the credit worthiness of the individual SPVs of the InvIT. Also, it does not reflect the ability of the SPVs to service the debt extended by the InvIT to the SPVs, if any. The rating of an InvIT is not a reflection of the pricing of the units issued by InvIT or its market performance or potential returns to the unit holders.

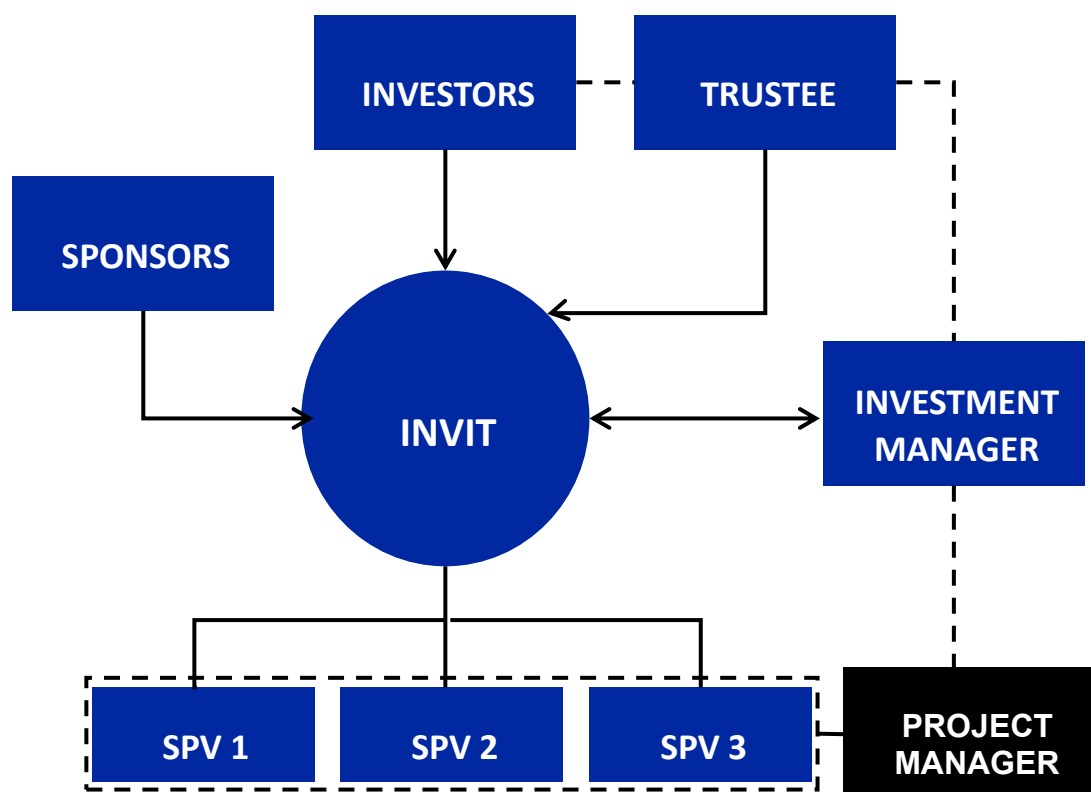
¹ These are as of June 2023 and may be changed by SEBI from time to time.

² The calculation of NDCF is to be defined in the offer document or placement memorandum of the InvIT. Generally, NDCF is calculated as PAT + Depreciation + loss/gain on sale of infrastructure assets – capex – repayment of external debt (principal) /redeemable preference shares/debentures etc. (adjusted for other non-cash expenses/ income).

³ Leverage – Debt/Enterprise value (enterprise value indicates the market value of the underlying assets as determined by an independent valuer)

⁴ For consolidated leverage to exceed 49% (up to 70%), the InvIT shall obtain a credit rating of “AAA” or equivalent for its consolidated borrowing and the proposed borrowing, utilize the funds only for acquisition or development of infrastructure projects, have a track record of at least six distributions on a continuous basis, and obtain approval of unitholders.

Structure of InvIT



The typical InvIT structure is shown in the above chart. The entity which sets up the InvIT and initially owns it is called the sponsor of the InvIT. The sponsor appoints the trustee for the InvIT, which holds the InvIT assets in trust for the benefit of the InvIT unitholders, in accordance with the Trust deed and the SEBI regulations. The trustee enters into an agreement with the investment manager called the investment management agreement, which lays down the roles and responsibilities of the investment manager towards the InvIT. The investment manager is responsible for the investment decisions.

The InvIT designates a project manager(s), who is responsible for the execution, the achievement of milestones, and the management of the underlying projects of the InvIT, in accordance with the project implementation agreement between the project manager, the SPV, and the trustee.

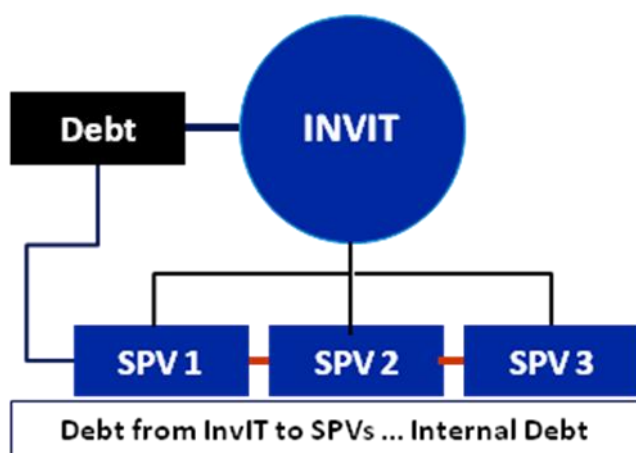
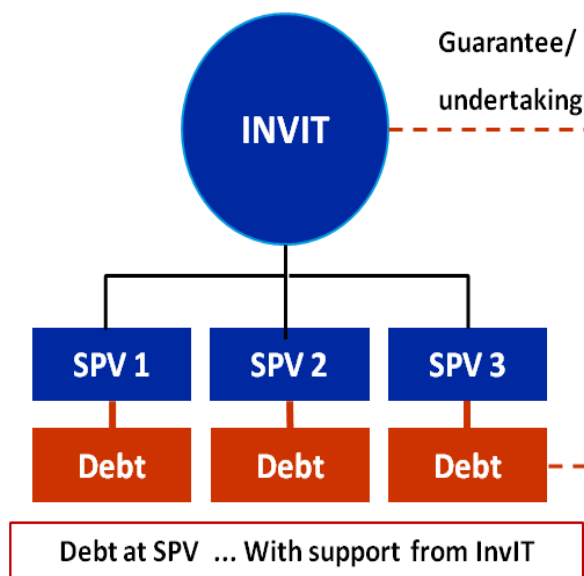
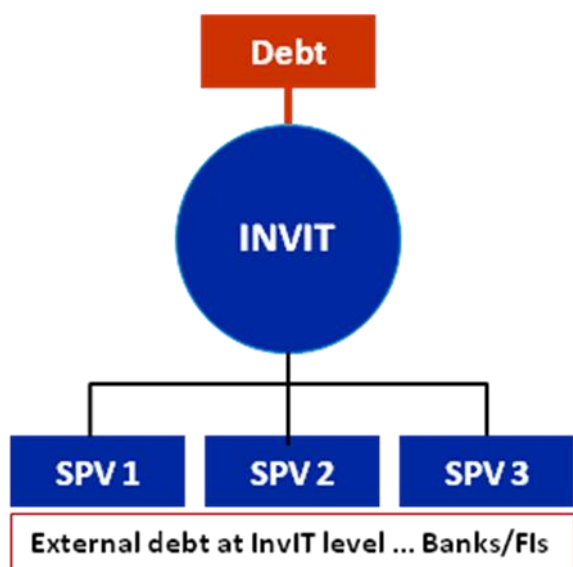
The sponsor generally transfers some of its operational projects to the InvIT in lieu of the units of the InvIT. The InvIT can also issue fresh units to new investors to raise funds. The sponsor can sell its units to other investors. However, the sponsor should hold a minimum 15% of the total units issued by the InvIT with a lock-in period of three years from the date of issuance of the InvIT units. The InvIT can use the funds raised to acquire new infrastructure projects or extend it to the SPVs, which can use it to repay their external borrowings.

The InvIT receives cash flows from the SPVs in the form of interest and principal on the loans extended to SPVs and dividend from the SPVs. As per the regulations, 90% of the NDCF has to be distributed to the unit holders, at least once in six months in the case of public InvITs and once in a year for privately placed InvITs.

The regulatory restriction on leverage, and on tax-efficient transmission of cash flows⁵ make InvITs more attractive to investors vis-à-vis the alternative of investing in individual assets.

⁵ Income generated by InvIT in the form of interest, dividend, or repayment of capital from the SPVs is a pass-through for the InvIT (no tax liability for InvIT)

Debt could be raised at any of these levels / combinations



The external debt could be raised either at the InvIT level (from banks/FIs) or at the SPV level. The debt raised at the SPV level could be credit enhanced through a guarantee/ undertaking from the InvIT.

ICRA's Credit Risk Assessment Framework

For analytical convenience, this document describes ICRA's methodology for rating InvITs under the following broad sections viz., business risk assessment, financial risk assessment and others.

Business risk assessment

- Assessment of individual assets
 - Execution risk
 - Revenue risk
 - Operating risk
 - Counter party credit risk
 - Regulatory Risk
- Portfolio diversity

Financial risk assessment

- Stability of cashflows
- Leverage, liquidity, and debt service coverage metrics
- Debt maturity profile and refinancing requirement
- Interest rate and forex risk
- Structural factors

Other elements of credit risk assessment

- Stakeholders' profile and track record
- Support to individual projects
- Event risk
- Accounting quality
- Contingent liabilities and off-balance sheet exposures

Management risk

- Management and trustee profile

Assessment of Environmental, Social and Corporate Governance Risks

Business Risk Assessment

Assessment of individual SPVs

While assessing the SPVs in different asset classes such as power generation (thermal, solar and wind), power transmission, power distribution, BOT roads (toll, annuity, HAM⁶), ports (landlord ports and terminal operators under BOT) and airports, etc, ICRA relies upon the specific rating methodologies for these segments, which are available on ICRA's website.

For toll road projects: [Rating Methodology - Roads \(BOT Toll\)](#)

For annuity road projects: [Rating Methodology - Roads \(Annuity\)](#)

For hybrid annuity model projects: [Rating Methodology - Roads \(Hybrid Annuity\)](#)

For thermal power producers: [Rating Methodology for Thermal Power Producers](#)

For airports: [Rating Methodology - Airports](#)

For ports: [Rating Methodology for Ports](#)

For wind projects: [Rating Methodology for Wind Power Producers](#)

For solar projects: [Rating Methodology for Solar Power Producers](#)

For transmission projects: [Rating Methodology for Transmission Projects](#)

The assessment is broadly summarised as below:

Execution risk

The InvIT is expected to have majority of the assets, which are operational in nature. However, in case there are some under-construction assets, the InvIT is exposed to execution risk. Wherever there are under-construction assets as a part of the InvIT's portfolio, ICRA evaluates the execution risk pertaining to those assets as per the approach mentioned in the corresponding methodologies specific to the asset type.

Revenue risk

Revenues for a project are a function of the demand, price, and asset availability. The revenue risk indicates the challenge posed by the project in case it is unable to generate adequate revenues to meet its operating expenses and debt servicing obligations. This may be either owing to weak demand at the price point at which it is offered or due to inability of the project to pass on the increase in input costs or both. For availability-based projects, if the output is below the desired levels, there is a revenue risk factor.

While assessing revenue risk, ICRA looks at the asset type and the contractual framework. The contractual framework determines whether the project is exposed to demand and price risks and if so, to what extent. While the demand and price risks are addressed through take-or-pay contracts for certain type of assets, the cost competitiveness of the project, and the financial position of the counterparty would determine to what extent the offtake contract will be honoured.

For assets under the pay-and-use model – viz. toll roads, airports, ports and in case of an existing asset, the track record of traffic movement may be well established and historical traffic data helps in gauging the trends and seasonality of traffic. However, for a project with limited operational track record, forecasting traffic volumes and measuring market risks can be challenging, given the absence of reliable and sufficient historical traffic data. ICRA, therefore, relies on independently

⁶ HAM: Hybrid annuity model

conducted traffic studies (by third-parties) to assess the revenue potential. The traffic studies are, nevertheless, suitably sensitised to assess the cash flow protection available to debt investors in case of a shortfall in traffic levels. For assets which are based on performance, like a power generation asset, the revenue risk can be dependent on multiple factors impacting its performance like availability of fuel, power evacuation infrastructure, etc. For assets which are based on availability like an annuity road project or a power transmission project, the revenue risk is lower and depend on the ability of the SPV to maintain the asset availability as per the contractual requirement. ICRA carries out a sensitivity analysis on the relevant revenue sensitive parameters to estimate the cash flows available under various scenarios and their adequacy to meet the various obligations, including those related to debt servicing.

Owing to evolving technologies and changing competitive landscapes, it is difficult to assess the competitive position of an asset over a long period. Competition may not be limited to similar assets but could also arise from assets serving a similar purpose – a toll road/ airport project could also face competition from other modes of transport. Similarly, the improved cost competitiveness of renewable power can provide stiff competition to conventional thermal power projects.

Operating risk

The operating risk indicates the challenges posed by the project if it does not conform to the required performance parameters over the period of the concession agreement / long-term purchase agreement. Timely and adequate operations and maintenance (O&M) activity is crucial for a project to remain healthy. Else, it could lead to a weakening of the project, while harming the revenue-generating capacity. This risk, if not properly addressed, could manifest itself in the form of reduced revenues, increased operating costs, increased capital expenditure (or major maintenance) at a later date and in extreme cases could lead to liquidated liabilities towards the offtaker.

ICRA assesses the track record and experience of the O&M contractor and analyses the O&M contract to assess the responsibilities of the contractor and the mitigants available (such as liquidated damages) to the SPV in case of any underperformance.

Counterparty credit risk

The counterparty's financial health is one of the key parameters influencing the lag between the contractual due date and the actual date of payments (receivable cycle) or the recoverability of the payment dues and also honouring of the offtake/purchase agreement. Counterparty diversification is especially important if the financial profile of some of the counterparties is weak. The credit risk of a project could be lower than that of the weakest counterparty in the portfolio of projects because of (a) the counterparty diversification (assuming other counterparties are strong) and (b) the presence of structural features (debt service reserve, various contingency reserves, etc).

Regulatory risk

ICRA evaluates the regulatory risk pertaining to the InvIT's underlying assets as per the approach mentioned in the corresponding methodologies specific to the asset type. This apart, from the overall InvIT's perspective, any changes in the regulatory guidelines such as changes in leverage cap, distribution policy, investment norms, and its impact on the credit profile is also monitored. The InvITs' adherence to the prevailing regulatory guidelines remains a crucial monitorable.

Portfolio diversity

The InvIT structure benefits from cash flow pooling across its portfolio of assets. Benefits of cash pooling can be maximised with reasonably well-diversified cash flows, which can be achieved through projects across geographies, asset classes and revenue models (such as toll and annuity in case of road assets), along with a diversified counterparty base. In this context, a well-diversified asset base with no single asset dominating the cash flows with low receivable concentration is viewed favourably.

Financial Risk Assessment

For financial risk assessment, initially the individual SPV's cash flows are assessed to determine the level of surplus cash flows at each SPV after meeting their operational expenses to arrive at cash flow available for debt servicing (CFADS). The CFADS for all underlying SPVs is consolidated while evaluating cash flows of the InvIT on account of the cash flow pooling benefit available with the InvIT. This is the approach followed for analysing SPVs that do not have any external debt or the external debt at the SPV does not have any restrictive covenant on upstreaming of cash flows to InvIT. However, if an SPV has restrictive covenants which prohibits upstreaming of surplus cash flows from SPV to the InvIT, ICRA consolidates only the surplus cash flows after debt servicing of such SPVs after factoring in these restrictive covenants, while evaluating the consolidated cash flows of the InvIT. The adequacy of such total CFADS, at the consolidated level, is assessed with respect to the InvITs' expenses and debt servicing obligations (including the external debt in the SPV).

The consolidated cash flows coverage ratios of an InvIT are compared with the benchmarks for the underlying asset class. For example, if an InvIT has toll road assets, the consolidated cash flow ratio of such InvIT are compared with the benchmark ratios for toll road entities. If an InvIT has multiple type of assets (e.g. a mix of toll road and annuity road), a sum-of-parts approach is followed factoring in the relative share of various asset classes in the InvIT's consolidated CFADS.

Stability of cash flows

Two InvITs with a similar set of base case debt coverage metrics could be rated differently depending on the stability of cash flows. For example, an InvIT with stable cash flow-generating assets (e.g., transmission assets and annuity road projects) may be rated higher when compared to the one with higher variability in cash flows such as toll road projects, despite both having similar debt coverage metrics in the base case.

While assessing the stability of cash flows, emphasis is laid on the stability which stems from the SPV's revenue stream, and its ability to control operating costs. In addition to demand and price risk, in a few contracts, the revenues are fixed, whereas the operating costs increase on a yearly basis. In a few cases (regulated assets), there could be a timing mismatch in terms of recovering certain costs.

Projects whose operations are stabilised, i.e., with at least two to three years of operational track record have more predictability on the cash flows and thus are viewed favourably. For annuity projects, the timeliness of semi-annuity payments and deductions due to lane unavailability would have been established. For toll road projects, the base traffic, along with the users' willingness to pay would have been established during this period. For power producers, the actual performance (especially PLF and plant availability) would have been analysed [compared with normative parameters for thermal and P-90⁷ or P-75 estimates in case of renewable power projects]. On the expenses front, the ability of the project manager to manage O&M costs remaining within the budgeted levels would have been assessed, especially for projects in which the O&M cost is not pass-through. In such cases, any mismatch between costs and revenues would adversely affect the stability of net cash flows. For projects with low operational track record, the uncertainties are higher.

Leverage, liquidity, and debt service coverage metrics

ICRA compares the leverage of an InvIT with those of its peers to assess its relative position, and cushion available with respect to the regulatory cap for the respective InvITs to assess the financial flexibility. Generally, a conservative leverage ratio is viewed favourably as it reflects a lower quantum of committed outflows. Nevertheless, a longer maturity profile and lower cost debt can partially offset the risk associated with a high financial leverage. The debt service coverage ratio (DSCR) is the key ratio which is analysed. The DSCR measures the cushion between debt servicing obligation and cash flows available for debt servicing (CFADS) in any given period (typically annual but may be quarterly/half-yearly especially for projects exposed to seasonality

⁷ P90 estimate of generation is the generation which is 90% likely to be produced over an average year.

and to match with debt repayment frequency). In addition, unencumbered cash balances, and undrawn lines of credit at consolidated level provide liquidity support and help the entity tide over temporary cash shortfalls.

Further, the pay-out dates for external debt, and the SPV debt (could be external or from InvIT) should be aligned with the inflows (adjusted for receivable cycle) to avoid any mismatch between the InvIT obligations and inflows.

Debt maturity profile and refinancing requirement

Ceteris paribus, the tenure of the term debt is a key driver for the debt coverage as entities with a longer tenure debt and similar levels of leverage will generally be more comfortably placed compared to entities with shorter tenure debt. Also, a ballooning repayment structure is viewed favourably, especially when most of the underlying assets are in the ramp-up phase, so that the burden on the cash flows of the InvIT during the initial years is lower. However, this is not applicable for projects with materially increasing uncertainty of cash flows towards the latter part of the project life.

While in most cases, the debt structure is fully amortising, there could be situations where some portion of the debt has refinancing risk. In such cases, financial flexibility of the InvIT to various refinancing options and availability of liquidity measures to tide over any possible delays in refinancing (due to temporary market disruptions) is assessed.

Projects with a long tail period or, in other words, high project life coverage ratio (PLCR) are better equipped to raise additional debt/ refinance existing debt with elongated tenor should there be a requirement. These are viewed favourably.

Interest rate and forex risk

The foreign currency risk can arise from unhedged liabilities, especially for entities with un-hedged foreign currency borrowings, which could pertain to part-funding of the project cost of the underlying assets or refinanced debt at the SPV or the InvIT. As there is limited scope for natural hedge, the focus here is on the hedging policy of the issuer to mitigate such risk for net foreign currency exposure. Similarly, the extent to which an issuer would be impacted by movements in interest rates is also evaluated.

Structural factors

Creation of the debt service reserve account (DSRA) to cover debt servicing obligations for some period (either in the form of cash deposits or in the form of a guarantee) and creation of a major maintenance reserve account to build sufficient funds for the scheduled major maintenance activities or provisions for any future bulky expenditure provide an additional comfort. Other forms of structural features include senior-subordinate debt structuring, trapping surplus cash flows on activation of triggers, etc. ICRA draws comfort from the presence of any restrictive debt covenants such as the InvIT being restricted to raise any further external debt.

Further, the lenders' consent for addition of new assets and the presence of an experienced trustee, who effectively controls the project cash flows and monitors the various reserves to be created as per the common loan agreement/debenture agreement on behalf of the debt investors are additional structural factors, which support the rating.

Covenant package

ICRA draws comfort from the restrictive debt covenants, which include prohibitions/ tests on additional indebtedness or liens, restrictions on the acquisition and sale of assets, limitations on investments (permitted investments), change of control/ownership, especially if the sponsors are important to the project.

	Positive	Neutral	Negative
Structural Features	<ol style="list-style-type: none"> 1. Lender administered cash flow waterfall with well-defined payment priorities 2. Dividend lock-up / restricted payment triggers with both backward and forward-looking tests 3. Trapping surpluses early and cash sweep mechanism 4. Immediate replenishment of debt service reserves (if dipped into) from subsequent operating cashflows 5. No debt acceleration triggers 6. Prohibitions/tests on additional indebtedness (including financial assistance) or liens, restrictions on the acquisition and sale of assets; limitations on investments (permitted investments) 	<ol style="list-style-type: none"> 1. Lender administered cash flow waterfall with well-defined payment priorities 2. Dividend lock-up / restricted payment triggers; covenant testing is not forward looking 3. Immediate replenishment of debt service reserves (if dipped into) from subsequent operating cashflows 4. All promoted debt instruments remaining sub-ordinated to senior secure debt and payments subject to consent of external lenders 5. Prohibitions/tests on additional indebtedness (including financial assistance) or liens, restrictions on the acquisition and sale of assets; limitations on investments (permitted investments) 	<ol style="list-style-type: none"> 1. No Escrow account 2. Lack of presence or lack of adherence to the specified cash flow waterfall Weak/no dividend lock up triggers 3. Debt service reserves with no replenishment 3. No cash flow sub-ordination of promoter debt and payment track record of recurring payments on promoter debt instruments 4. Debt acceleration triggers 5. Put options during debt tenure 6. Additional indebtedness (including financial assistance) or liens is permitted; no restrictions on investments (permitted investments)

Other Elements of Credit Risk Assessment

Stakeholders' profile and track record

The credit profile of an InvIT cannot be completely de-linked from the sponsor's profile and track record. There are provisions in the InvIT structure that make it independent from the sponsor. Nevertheless, generally the sponsor is involved in the O&M of the assets. A weak sponsor or deterioration in sponsor's profile can have a bearing on the quality of the O&M. While the InvIT can replace the O&M contractor with a third party, it can result in some disruption during the transition phase. Hence, strong operational track record and financial profile of the sponsor does add to some comfort for the assessment of an InvIT's profile.

Support to individual projects

Given the highly capital-intensive nature of the infrastructure projects, low operational expenses and finite life of the assets, the emphasis is on the internal rate of return (IRR) and net present value (NPV). However, some projects, despite a positive IRR, may face some short-term cash flow mismatches and require funding support from the InvIT. It is to be noted that InvIT is not a sponsor to provide unlimited funding support in case of deterioration of the SPVs' financials. It is only a collective investment vehicle and its ability to infuse funds depends on the available surplus. In some instances, the InvIT may not have the economic incentive for supporting the project, particularly if the project becomes financially unviable, in which case there can be an impact on the operations of the project, which may lead to the concessionaire event of default and lenders exercising their substitution rights.

Event risk

Given the limited ability to negotiate increased cost/ revenue disruptions, the adverse effect of any event risk on the individual SPVs housed under an InvIT could be more pronounced. The adequacy and timeliness of the pay-outs under various termination events like force majeure, changes in law, events of default are assessed. The timeliness of termination pay-outs is again a function of the counterparty's credit profile. While certain event-based risks can be hedged through insurance cover, the type

of insurance cover with respect to the risk covered and its adequacy in the event of catastrophic losses and disruption of normal business are evaluated. Upon occurrence of any of the above-mentioned events, the nature of the event and its effect on the cash flows is assessed. While the impact of an adverse event on an InvIT is relatively lower as compared to a single asset SPV, given the presence of multiple assets, such events can still have a material impact on the overall credit profile of the InvITs as the termination pay-outs, insurance proceeds would likely be received only post default.

Accounting quality

The financial analysis begins with a review of the InvIT's accounting quality. Here, the accounting policies, notes to accounts and auditors' comments that are part of the annual report are reviewed.

Contingent liabilities/ Off-balance sheet exposure

In this case, the likelihood of devolvement of contingent liabilities / off-balance sheet exposures of the SPVs and the InvIT and the financial implications of the same are evaluated.

Management Risk Assessment

Management quality

All debt ratings incorporate an assessment of the quality of the management, as well as the strengths/weaknesses arising from the sponsor being a part of a group. Usually, a detailed discussion is held with the management to understand its investment objectives, plans and strategies, and views on past performance. Some of the other points assessed are:

- a. Investment manager (IM) and trustee's experience and track record
- b. Consistency in the stated financial policy
- c. Project manager's experience and track record
- d. Investment process and objectives
- e. The issuer's policies on leveraging, rationale for debt raising, balance between leverage and returns, interest risks and currency risks
- f. Asset acquisition /asset diversification strategy, assets in pipeline

Assessment of Environmental, Social, and Governance Risks

The assessment of the environmental, social and governance (ESG) risks by ICRA involves a broad range of considerations that pertain to the sustainability of an entity, with focus on aspects that can have a material impact on its credit quality. While the environmental (E) and social (S) risks tend to be both sector-related as well as entity-specific and could be driven by external factors such as regulations or demographic changes, the governance (G) risks are largely entity-driven. The impact of the E&S risks on an entity's credit profile tends to be asymmetric. If the ESG risks are material but unmitigated, these generally translate into pulling down the rating, but generally the ratings are not pushed up even when the ESG context is favourable.

Environmental and social risks

While undertaking the credit assessment of entities, ICRA seeks to incorporate all relevant credit considerations into its rating decisions and take a forward-looking view on the risks and the mitigants. The relevant credit considerations include (sometimes overtly, sometimes covertly) the E&S factors that could affect the rated entity/ transaction. For InvITs, the E&S risks are linked to the underlying assets held by InvIT.

While ICRA's analytical approach does not explicitly disaggregate these risks to assess their impact on the rating, these risks are often assessed broadly. Further, it is not always feasible to fully or precisely disaggregate the sub-components of E&S risks in credit analysis since these considerations often tend to overlap. That said, the materiality of the E&S risks and the time horizon over which they are expected to crystallise differ widely across sectors and entities. In some cases, while the E&S risks could be material, their effect on the credit profile may be muted because of other fundamental strengths of the entity. In other cases, the adverse impact of the E&S risks is likely to play out in the future and hence these considerations do not necessarily weigh on the rating today with the expectation that by then they would possibly adapt themselves by realigning their business model.

While evaluating the E&S risks, ICRA's objective is only to assess the direct and indirect risks that an entity faces and how it already is or is intending to mitigate the impact of such risks on its credit profile. As an example, ICRA only assesses whether an entity is exposed to physical climate risks, or carbon transition risks such as those arising from changes in regulations or other environmental and social risks and seeks to understand the various mitigation and adaptation approaches that the entity is implementing to mollify these risks. Notwithstanding the above, as an example, it is possible that even if an entity A has a higher carbon footprint than entity B, it does not materially affect ICRA's credit opinion on entity A. This is because ICRA's credit opinion on an entity considers a wide gamut of credit relevant factors and the E&S factors are only one among those.

The details on various E&S considerations for the various asset classes held by InvITs can be referred to from the respective sectoral methodologies, which are available on ICRA's website.

Governance risks

A sound corporate governance structure attempts to make clear the distinction of power and responsibilities between the Board of Directors and the management. The constitution of an entity's board and the Board of Directors' participation in strategy formulation, besides the entity's adherence to legal and statutory compliance requirements are factored in during credit assessments. ICRA seeks to gain a qualitative understanding of an entity's commitment to following transparent and credible practices depending on the way its financial statements are reported, the level of disclosures, consistency in communication and the openness about sharing information during the credit rating exercise.

Summing Up

ICRA's credit ratings are a symbolic representation of its opinion on the relative credit risk associated with the instrument being rated. This opinion is arrived at following a detailed evaluation of the issuer's business and financial risks, its competitive strengths, its likely cash flows over the life of the instrument being rated and the adequacy of such cash flows vis-à-vis its debt servicing obligations and other funding requirements.

Overall, ICRA has a more favourable opinion on InvITs that have a diversified asset base with stable cash flows and strong counterparties, which operate in sectors with stable and well-established regulatory framework. ICRA draws comfort from a high DSCR ratio with a long tail period (to facilitate refinancing if required) at the consolidated level. The presence of structural features like adequately funded DSRA, contingency and O&M reserves with restrictive covenants on additional debt and lenders' consent for addition of new assets in the InvIT are credit positives. Further, a material deterioration in risk profile of a key underlying asset could adversely affect the InvIT's credit profile.

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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