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UNLOCKING CAPITAL SAFELY: A GUIDE TO NON-RECOURSE BASED FINANCING

GURANPREET SINGH SARNA & ARPANA SINGH

Non-recourse project financing is a category of funding that is commonly preferred in large-scale ventures and capital investment. Unlike traditional financing, non-recourse based financing allows the borrower to secure funding without offering of collaterals. This type of financing is commonly used for high-risk ventures of project financing namely real estate sector projects, energy projects, and other infrastructure projects.

1. WHAT IS NON-RECOURSE BASED FINANCING?

Non-recourse based financing relies on project assets and cash flows to secure the facility provided by the lenders, rather than the borrower's personal assets. In the event of project failure, the lender cannot pursue the borrower's personal assets for reimbursement. Instead, they can only claim the project assets and cash flows. This financing method is predominantly employed for large-scale, high-risk projects that necessitate substantial capital investment.

2. BENEFITS OF NON-RECOURSE BASED FINANCING

Non-recourse based financing presents a significant advantage by allowing borrowers to secure funding without the requirement of offering collateral. This feature is particularly valuable for ventures categorized as high-risk, as it shields borrowers from potential personal financial liabilities in the event of project failure. By removing the necessity for collateral, non-recourse financing liberates borrowers from the burden of having to pledge personal assets, thereby offering them a greater degree of financial security and liberty coupled with freedom to better explore the market.

The accessibility of larger capital sums through non-recourse financing presents a significant advantage, particularly for borrowers engaged in large-scale or high-risk projects. Traditional financing methods often come with stringent collateral requirements and rigorous risk assessments, which can limit the amount of capital that borrowers can access. This limitation is especially challenging for projects assessed at high-risk, wherein securing adequate funding can be a major obstacle.

On the contrary, non-recourse based financing offers a more flexible approach. Lenders opting for non-recourse based financing are generally more willing to assume greater risk, allowing them to offer borrowers access to larger pools of capital. This flexibility is a key benefit for borrowers, as it enables them to secure the substantial funds necessary to meet the financial requirement for the achievement of the projects.

For large-scale ventures, which typically require significant upfront investment, this influx of capital is invaluable. It allows borrowers to cover critical costs, from initial development to ongoing operations, ensuring that their projects can move forward without the financial constraints that often accompany traditional financing. Ultimately, the ability to access larger sums through non-recourse financing can be a game-changer for ambitious projects, providing the financial foundation needed to achieve their objectives.

In essence, the flexibility and risk mitigation offered by non-recourse project financing not only alleviate the financial burden on borrowers but also facilitate the execution of ambitious and high-risk projects by providing access to the necessary capital resources.

3. DRAWBACKS OF NON-RECOURSE PROJECT FINANCING

The main disadvantages of a non-recourse based financings are tied to the loan terms a borrower can receive. Since the risks of the lender associated with mode of non-recurse debt are higher than the traditional debt process, thereby the lender negotiates a higher rate of interest or agrees onto undervalue loan amount against the property value set and agreed to be as charged as security. The measures is aimed at lower the risk of the lender associated with the facility assisted.

This typically makes non-recourse based financing more expensive. In essence, the borrowers of non-recourse based debt are paying the lender involved to transfer the responsibility for the debt to the bank, credit union, insurance companies, or other lending institution.

Further, potential disadvantage for the borrower is interlinked with the carve-out associated with non-recourse clause in the loan. Although a lender usually cannot go after a borrower's personal assets or income beyond the property with non-recourse loans, most of these loans include "bad boy carve-outs." These carve-outs are exceptions to the non-recourse terms and make the borrower personally liable for specific actions or breaches, such as fraud or other misconduct.

These provisions indicate that if the borrower provides false or incorrect information with the intention of concealment of facts or misrepresentation about the assets or themselves, or submits fraudulent financial documents pertaining to compliances, liability amongst others such as tax returns or statements, they lose the non-recourse protection and become fully accountable for the loan. The acts may also encompass other actions, such as obtaining subordinate financing when it's prohibited or even paying taxes late and related defaults.

4. NON-RECOURSE PROJECT FINANCING VS OTHER OPTIONS

When considering non-recourse based financing, it's important to compare it to other financing options. For example, opting traditional financing method may be a better for project which is evaluated as low risk bearing, since it ideally provides for lower interest rates and corresponding processing fees. Futher, equity financing might pan out as an more viable option for projects that require ongoing and long term funding, as the same enables the borrower to retain the ownership of project and potentially benefit from its in way of long-term success.

5. BAD BOY CARVE OUTS

In the arrangement non-recourse based financing, the lenders do have one advantage when offering non-recourse loans by means of the clause called "the bad boy carve out." The "bad boy carve-out" refers to a clause included in nearly all non-recourse transactions wherein the stringent nature of the non-recourse based financing is diluted to provide comfort to the lender. In the event that the borrower conducts any fraudulent activity or misrepresents themselves in any way, the non-recourse loan terms is rendered void ab inito and thereby acquires the nature of traditional financing or a full recourse based loan and the lender can then go after any and all of the borrower's assets in a case of default with the ambit if the bad boy carve out. Few of the general defaults that can trigger the bad boy carve out clause to take effect includes:

- Inconsistency in paying property tax
- Inadequate insurance cover maintained for the property
- Intentional misrepresentation of financial viability
- Going bankrupt to avoid repayment

CONCLUSION

Non-Recourse Project Funding has emerged as a pivotal and indispensable tool for financing the realization of large-scale infrastructure projects. Its unique attributes offer a flexible and efficient mechanism to mobilize capital while effectively mitigating risks for both project sponsors and investors. By leveraging project-specific assets and revenue streams as collateral, non-recourse financing not only accelerates the development of critical infrastructure but also plays a pivotal role in driving economic growth, enhancing public services, and elevating the overall quality of life within communities.

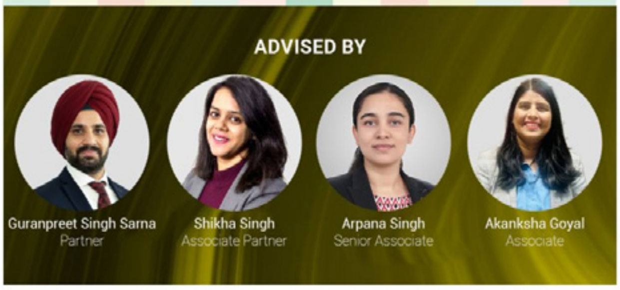
However, the successful implementation of non-recourse project funding necessitates a comprehensive approach that encompasses careful structuring, meticulous risk management, and seamless collaboration among stakeholders. It is through these concerted efforts that the long-term sustainability and viability of infrastructure projects can be ensured, thereby maximizing their positive impact on society and fostering enduring prosperity.

The article was originally published on Mondaq. *Access via https://mondaq.com/india/financial-services/1525176/unlocking-capital-safely-a-guide-to-non-recourse-based-financing*

NOTABLE DEALS

DEALS & MORE

The Firm conducted a rigorous review and comprehensive examination of the internal policies of Nonghyup Bank (India), one of the overseas branches of NongHyup Bank, South Korea, to ensure that the bank's policies are aligned with regulatory requirements, industry best practices, and the highest standards of governance and compliance.



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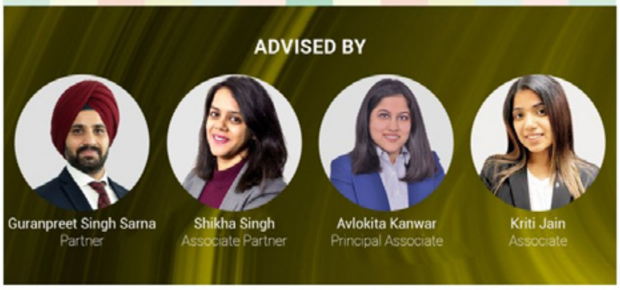
Advised Power Finance Corporation Limited as its legal counsel in connection of financial assistance aggregating to INR 310.74 Crore made available to Acme Pokhran Private Limited for setting up of 49.50 MW wind power project in the state of Gujarat, interalia, safeguarding the interest of the lender vis-à-vis the transaction from the impact of borrower having its subsidiary.



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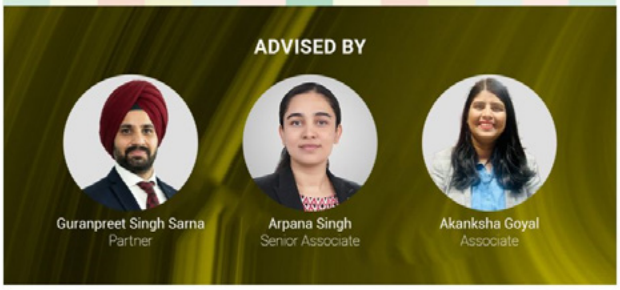
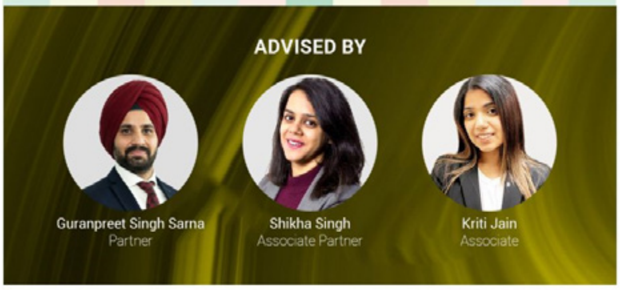
Advised Piramal Enterprises Limited for financial assistance of INR 115.00 Crore granted to Pan Ban Associates Private Limited, for the purposes of refinance and acquisition of inventory plots in the project developed in the state of Punjab.



DEALS & MORE

Advised India Infradebt Limited as its legal counsel in connection with a refinancing and top-up facility aggregating INR 1,876.5 million made available to 4 SPVs of AmpIn Energy Transition group with a co-obligor/cross guarantee structure for their power projects of approximately 50 MW in the state of Maharashtra.



THE PODIUM

Sonal Verma, Partner (ESG) spoke at the Annual Legal Summit of CK Birla Group on various aspects related to ESG.

Sonal Verma, Partner (ESG) spoke at The 9th Annual Media, Advertising & Entertainment Legal Summit 2024, Mumbai on “Navigating Complexities in OTT & Broadcasting”

Sonal Verma, Partner (ESG) participated as a Panellist in the **10th Annual Pharma Legal and Compliance Summit 2024** in Mumbai.

Naveli Reshamwalla, Associate Partner, had the privilege of presenting insights on **“The Evolving Regulatory Landscape: Is There a Prescription for Perfection?**

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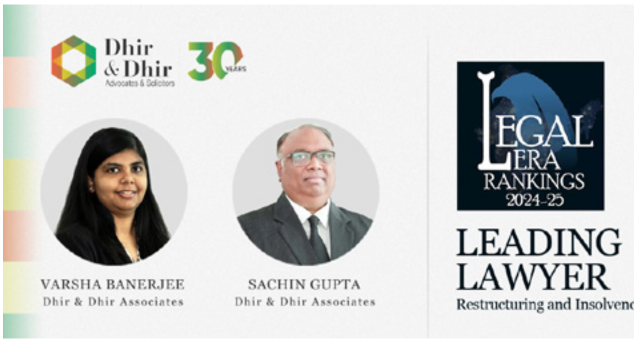
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Partner
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RISING STAR PARTNER
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Shikha Singh
Associate Partner
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FIRM IN THE NEWS

mint

Raveendran loses immediate control of Byju's as NCLT admits BCCI insolvency plea over ₹158 crore in dues

Read more on MINT

The resolution professional's main responsibility is to collate information on the entire dues that Byju's owes to all its stakeholders, and create a committee of creditors, said Alok Dhir, founder and managing partner at law firm Dhir & Dhir Associates. "In theory, the management is then passed on to the hands of the creditors."

NCLT admits insolvency plea against Byju's. Here's what it means for the edtech platform

Read more on MINT

Budget 2024 Govt announces measures to speed up insolvency resolution

Read more on MINT

Setback for Byju's as Supreme Court restores insolvency case, raps NCLAT for overreach.

"The judgment, in effect, instils confidence of the creditors having superior and/or prior charge over assets of a company including funds available with the company. It protects any creditors having subservient rights from stealing a march over other creditors with assistance of a court/tribunal," Alok Dhir, founder and managing partner of Dhir & Dhir Associates.

Read more on MINT

FIRM IN THE NEWS

Dhir & Dhir Associates Advises Jaypee Infratech Limited and Lakshdeep Group on Acquisition of Jaypee Healthcare Limited by Max Healthcare Institute Limited.”

“We are proud to have represented Jaypee Infratech and Lakshdeep Group in this crucial transaction that not only resolves the insolvency of Jaypee Healthcare Limited but also brings a major industry player, Max Healthcare, on board. This transaction ensures that the interests of all stakeholders are fulfilled and paves the way for growth and recovery for Jaypee Healthcare.” Alok Dhir, founder and managing partner of Dhir & Dhir Associates.

Read more on Republic world

Dhir & Dhir Associates advised and represented Jaypee Infratech and Lakshdeep Group in the entire legal proceedings including proceedings before the NCLT/ NCLAT, ensuring compliance with regulatory requirements and protecting the interests of all stakeholders involved.

Read more on Bar & Bench

Read more on Outlook India

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Dhir & Dhir Associates is a leading full-service law firm in India serving as a single-window legal and regulatory advisor globally. It has offices in New Delhi, Mumbai, Hyderabad and a representative office in Japan. The firm's areas of practice include Restructuring and Insolvency, Corporate/Commercial Advisory and M&A, Real Estate, Banking and Finance, Dispute Resolution, Capital Markets, Infrastructure & Energy, Environmental, Social & Governance, IPR, Technology, Media & Telecommunications, Employment Law and Consumer Law.

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