The Hyderabad Metro Rail Model

Piyush Joshi (2008)

The Hyderabad metro rail project is a 71 kilometer link estimated to cost about Rs 12,000 crores. The Government of Andhra Pradesh had decided implement the project on a BOT basis, by a consortium to be selected through a competitive bidding process. In order to make the project viable for private developers, the right to develop real estate on an aggregate of 269 acres of land around stations and depots was made part of the Project. The concession is for a period of 35 years with a possibility of extension by additional 25 years. The model vests private developers with the right to develop real estate, thereby creating a revenue stream that would finance the development, construction, operation and maintenance of the infrastructure facility.

The financial bid was the main criteria for selection of the successful bidder. Bidders for the project were required to state whether they would need government funding to implement the project and quote the extent of such grant funding, or whether they were willing to provide revenue to the government in consideration of the grant of the concession. The consortium of Mayatas Infrastructure, the real estate company of the Satyam group, reportedly offered to pay the Government Rs 30,300 crore over the life of the concession, (which, if discounted at 13.5 per cent a year is worth Rs 1,240 crore today). Mayatas was selected as the successful bidder.

The Planning Commission has recommended that the Hyderabad model be adopted for all future metro projects. This model however, needs to be reviewed closely before being replicated. An essential policy question that needs to be addressed is whether an infrastructure development model should focus on monetizing the commercial value of government land holdings or should it focus on a robust structure for due implementation and continued operations of critical infrastructure facilities?

A robust project structure requires that the implementation of the infrastructure project be shielded, to the extent possible, from the various risks associated with such projects. Projects are typically structured through risk allocation coupled with risk management and risk mitigation measures.

The Hyderabad model injects a volatile real estate risk into the project implementation structure. The model effectively exposes and closely ties the continued construction, operation and maintenance of the metro project to the fluctuations of the real estate market. Real estate risks, one hardy needs to state, are volatile and unpredictable.

In a typical PPP infrastructure project, the selected consortium implements the project by incorporating a new company for the specific purpose of implementing the project. If the real estate leg of the project does not turn out to be as lucrative as envisaged at the time of bidding, the project company can be bankrupted. This would inevitably lead to a situation where the Government would have to take over the project. Furthermore, in situations where a single infrastructure project involves multiple sub-projects, it is common for subsidiary companies to be incorporated to undertake the sub-project components. For example, if the metro railway concessionaire in Hyderabad creates a subsidiary for the real estate development, the benefits of real estate activity can be trapped by the selected consortium in the subsidiary and not flow directly into the project company holding the concession. This has recently been done by DIAL, the concessionaire for the Delhi Airport.

The Hyderabad model is being justified on the grounds that real estate development has been integral to the implementation of successful metro railway projects worldwide. Hong Kong is being provided as the one of the best examples for this structure as it is also one of the very few profitable metro railways in the world. In this regard, it is important to note the few critical differences between the Hyderabad model and the Hong Kong model. Firstly, the Hong Kong metro was commenced as a Government project in the late 1960s; Secondly. the privatization of the Hong Kong metro, which occurred only in 2001, was not as a BOT concession to a single selected private consortium, but through an international public offering of one billion shares, (which constituted a minority of the shareholding) making the Hong Kong metro company the largest held public company in Hong Kong. Thirdly, The real estate component of the Hong Kong metro has the following distinct elements: (a) developers undertaking suburban development that are desirous to have a metro line to the sub-way have shared in the cost of extension of the line to the relevant areas, (b) real estate development is taken by the Hong Kong metro company in partnership with real estate developers; it is generally not spun off and vested with private developers and (c) the real estate revenue of the Hong Kong metro are distributed between profits from real estate development (i.e., obtaining revenue on grant of development right), rental and property management. This results in distribution of the real estate risks between immediate monetization (getting money for granting development rights) to long term value capture (having a rental portfolio).

In the Hyderabad model: (i) the entire project has been handed over to a private consortium even before it has been designed, its standards and specifications fixed or its routes determined, (ii) government supervision and monitoring would only be post facto and not at management level, (iii) since there are hardly any regulations on real estate development and pricing, there would be little regulation in relation to the real estate portion of this project which is a critical component for its continued implementation, (iv) there is no clarity on mitigation measures undertaken to protect the project from the real estate development risks and fluctuations in the real estate market and (v) the entire focus of the selection seems to have been on immediate monetization of land value rather than ensuring a robust project implementation structure.

The afore-mentioned issues should be looked at more carefully and suitable mitigation measures should be incorporated into the structure.

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