# Rating Approach to Consolidate Cash Flows Arising from Infrastructure Entities

**Special Report**

## Scope

India Ratings and Research (Ind-Ra) applies the approach outlined in this report to consolidate cash flows from infrastructure project companies including special purpose vehicles (SPVs). This includes several prevalent structures including the obligor/co-obligor structure and pooling model structure that are used to service debt out of consolidated cash flows of all or some of its constituents. This report is also applicable to rate the debt of infrastructure investment trusts (InvITs) duly constituted under SEBI InvIT regulations.

This report outlines the assessment of credit risk in consolidated cash flows where the homogeneous/heterogeneous constituent assets/SPVs are usually housed under one legal framework like InvITs or other such pool of infrastructure assets legally bound to service the debt obligations collectively through various obligor-co-obligor structures. The credit rating reflects the combined strength of the constituents' (or InvIT's) cash flows to meet debt obligations in a timely manner.

Issuer ratings can be assigned to InvITs or similar such structures. The report also discusses assigning ratings on the various categories of debt of the consolidated InvIT's system as a whole, comprising all the underlying SPVs. That being said, if there are external debts at the constituent-level SPVs, they will be rated in accordance with the master criteria/sector-specific risks. This report will be also applied depending on the financing documents specifications. Master criteria/sector-specific criteria deal with project-level risks and this report deals with debt structure and consolidation-related aspects.

InvITs are regulated by SEBI and are permitted to issue units (equivalent to equity) that are listed and traded in the bourses. The rating does not in any way signify or indicate the returns to unit holders nor does it signify any potential yield levels to unit holders, and therefore, the rating on the debt of InvIT should not be construed as a rating on InvIT's units. It is also not an indicator of the credit profile of any individual assets which are part of the InvIT's portfolio as these are evaluated as a pool.

There are several financing structures based on legal agreements and financing documents. This report deals with the broad approach to rate those structures. The approach will depend on a case-to-case basis based on financing documents. Those structures including InvITs are generally referred to in this report as 'pool'. The agency's wire on Pooled Structures And InvITs To Boost Market Access For Developers also briefly touches on the approach; however, this report extensively addresses it.

In this report; the terms 'SPVs', 'constituents', 'constituent SPVs', 'assets' and 'companies' have the same meaning, unless otherwise stated. Unless it is explicitly stated to the contrary, the analytical pointers in this report are generally adopted for InvIT and obligor/co-obligor structure and/or the pool.

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## Key Rating Factors

### Credit Quality of Individual Pool Constituents

The most important driver of such pool's rating is the credit quality of its underlying assets or constituent SPVs. Ind-Ra recognises that the entire cash flow available to the pool/InvIT to service its own debt is generated by the quality of cash flows of the constituents or co-obligors. Accordingly, the credit risk associated with these cash flows is best assessed at the individual asset level. Therefore, it is important that the individual assets in the portfolio are assessed for its robustness. This is one of the most important drivers of a consolidated pool's rating, be it InvIT or an obligor/co-obligor structure.

The credit quality of the constituents/co-obligors in the portfolio is assessed using the sector-specific criteria applicable to the entity; or the master criteria if there are no sector-specific criteria.

### Portfolio Credit Quality

The credit quality of a portfolio as a single unit could be higher than the credit quality of the individual constituents of a pool. This is because the cash flows of the pool as a single unit can exhibit lesser volatility and more robustness than SPVs taken individually. Furthermore, diversification helps the pool. The exact rating of the pool in relation to the individual SPVs would be determined by the extent of diversification benefits the individual constituents would provide. Portfolio diversification is determined by the number of assets in the pool having wide-ranging drivers impacting the business and credit profile of the assets. While assigning the rating, Ind-Ra applies stress cases in accordance to the rating category and the ability to withstand the stress case by the pool is higher in case of diversified portfolio.

Diversification could be through a geographical or counterparty or asset class. For example, the presence of diverse counterparties in a pool or asset classes such as wind and solar in a pool or assets spread across various states or a mix of availability based and toll assets.

Two pools with similar financial metrics could have different rating levels based on the resilience of the structure to various stressed scenarios. A pool having higher revenue diversity and/or higher counterparty diversity is more robust than a single asset or a more homogeneous pool.

### Cash Flow Strength at Consolidated Pool Level or InvIT Level

The methodology would assess liability profile at the consolidated/InvIT level and appropriately assess mismatches, if any, in debt service requirements and cash inflow from operational assets depending on the type of consolidation discussed in the following paragraphs.

### Financing Documents Drives Methodology for Consolidation

The financing agreement/debenture documents drive the methodology for consolidation. Broadly, consolidation can be grouped into two. First is the complete consolidation and the next is the consolidation of residual cash flows. These are two extremes and several variations are possible within them. The exact method of consolidation and arriving at the rating will mainly depend on the financing and escrow documents of all the constituent projects.

### Other Key Rating Drivers

In case of InvITs, Ind-Ra also considers the investment strategy detailed in the offer documents/term sheets/financing documents. The agency will also ensure that its assumptions appropriately confirm to the specifics, if any, of the investment strategy, such as minimum cash holding or a voluntary debt ceiling. The experience of sponsors, investment managers and project managers would also be reviewed on the basis of their track records of performing similar tasks, as well is in terms of adherence to the standards of corporate governance. The performance track record will be incorporated in assessing the quality of individual assets.

The experience of the sponsors and investment managers may be considered as a key driver for the individual rating of 'yet to be completed' projects which are in the portfolio.

## Churn in the Portfolio

In case of an InvIT, Ind-Ra would review the rating each time a new asset is added or divested from a portfolio; the new asset would be assessed on both individual basis and consolidated bases and its impact on portfolio rating would be determined. Normally, constituent assets will more or less be frozen in case of an obligor-co-obligor structure. However, if the portfolio is kept open, the same methodology as described above will be used to assess the quality of the consolidated profile of the obligor/co-obligor structure.

The rating will normally correspond to the current portfolio and factors in any planned additions and disposals. Any unplanned new additions or deletions will be treated as events triggering a rating review. The agency will evaluate the InvIT's stated investment philosophy and test the portfolio credit quality sustenance factor over a long period of time. Any new acquisitions would be separately evaluated by the agency after/at the time of acquisition, and if it denotes a deviation from the stated investment policy, the asset acquisition may impact the InvIT's credit quality.

That being said, Ind-Ra will take into account any potential acquisition of asset along with available information based on the historical track record of the investment manager. However, Ind-Ra would re-evaluate the rating when a new asset is acquired and compare the same in line with the base case assumption. Similarly, the agency would re-evaluate the ratings for disposals.

## Methodology for consolidation

As mentioned earlier, the methodology of consolidation of cash flows is primarily dependent on financial documents. There are several ways of consolidation although they can broadly be categorised into two main methods:

## Two Broad types of Consolidation

1. Complete consolidation
2. Residual cash flow consolidation

The first method is consolidation from the top line (herein referred to as top line/complete consolidation); where simply the revenues of the constituent assets/SPVs and the respective expenses are consolidated line by line (subject to tax treatment) and the availability of cash flows to service debt is assessed in a consolidated manner rather than looking at individual asset/SPV's cash flows. Here, the entire pool is looked at as a unit as whole and fund flows between projects are without any restrictions.

The second method is the consolidation of residual cash flows (herein referred to as residual consolidation). The prime assumption is that residual cash flows will be used towards meeting any shortfall in the debt service of other SPVs/constituents before it could be distributed (but after the individual SPV's debt service). The distribution frequency is determined by financing documents/applicable regulation. However, the fungibility among the constituent SPVs and the frequency of availability of such cash flows is more important in determining the rating. Residual consolidation happens after covenant testing.

EBITDA level consolidation and cash flow available for debt service (CFADS) level consolidation generally fits in between but more towards complete consolidation, given EBITDA and CFADS are critical for debt service.

In case covenant testing is done for individual projects prior to providing support to the other assets in the pool, Ind-Ra would analyse the nature and frequency of the testing. The agency would adopt a distance to lock-up ratio compared to the conventional debt service coverage ratios (DSCR) in such cases.

The decision to arrive at complete consolidation or residual consolidation is sensitive to timing – the time of debt service, O&M expenses, lifecycle costs, debt service etc.

For example, if the residual cash flow testing is done annually and the debt service of SPVs is done monthly, the constituents despite having significant residual cash flows cannot offer much help to the assets that require funds to meet their shortfall. Therefore, financing documents determine the approach to assess the structure.

## Complete Consolidation Approach

Top line consolidation is generally used by the agency where, under the financial documents, the obligors are treated as one single borrower. The loan will be treated as a common obligation for all the constituent SPVs and the debt may not necessarily be identified SPV wise. The obligation is joint and several. In some cases, the loans may be identified constituent-wise; however, the legal clauses in the documents will be so structured to ensure that the loan is a common obligation for all the SPVs. In case of SPV-wise loans, a single escrow mechanism or a cash flow waterfall consolidating cash flows before debt servicing level (examples are EBITDA-level consolidation and CFADS-level consolidation) will also warrant top line consolidation.

If cross guarantees are continuing guarantees (which do not fall off on the achievement of certain stipulations/conditions) and provided on a joint and several basis, there is a strong case for top line consolidation.

### *Cross Default Clauses*

The main aspect of a cross-default clause is that if one obligor defaults, the other obligor is deemed to be in default; although in actual there is no payment or technical default by the other obligor on a standalone basis. A payment default is more sensitive than a technical default; since, technical default can be cured in the immediate term and a timeline is generally assigned within which it has to be cured. According to some financial documents, a prolonged existence of technical default may result in acceleration. Ind-Ra analyses the probability of continuance of such a technical default and the possibility of curability of the default.

(Note: Technical default is not a payment or a financial default. Technical default refers to a breach of covenants or failure to adhere to certain covenants within the stipulated time, without actually defaulting on debt service.)

If a technical default has occurred, Ind-Ra does not immediately reflect a change in the rating of the project, however analyses the possibility of such a continued occurrence. If in the agency’s opinion such a technical default is likely to continue; cannot be resolved in the immediate term and will impact the existing distance to the payment default; the agency will normally review the credit for a rating action.

If in an obligor-co-obligor or an InvIT structure, one or more entities are in technical default (not a payment default or a financial default), Ind-Ra first applies the appropriate consolidation approach and test the adequacy of debt service. Secondly, the severity of the technical default and its possibility of continuance of such a default are analysed. If the technical default is irreparable over the short term and is forcing other co-obligors to a payment/technical default in future, a rating action will be taken.

Under normal circumstances, if there is a cross default clause in the financing documents between two independent entities, without allowing for inter-company cash flow movements, the rating will be constrained by the weaker entity’s rating or it could prevent the stronger entity to be rated at a level where it otherwise would have been rated (or had it been independently rated). However, if the cash flow is freely fungible between the entities, the assessment of those entities can be on a consolidated basis.

When analysing the obligor-co-obligor structure, a similar approach will be followed. The presumption is that a cross default clause is introduced in the financing documents to connect the cash flows of all the entities; a test will be carried out for a consolidated debt service shortfall or shortfall to meet the covenants or funds required to avoid a potential default for the entire structure. In an obligor-co-obligor structure containing SPVs, Ind-Ra believes that a cross-default is introduced to perform a balancing function between higher performing assets and weaker assets. However in those cases, there should not be any restriction in the movement of cash between the entities; just, not necessarily by way of distribution.

The question arises as to whether cash flows will have to be consolidated at the top line level or only at a residual cash flow level. This was dealt elsewhere briefly in the earlier paragraphs and also in detail in the following paragraphs.

### *Cross-company Cash Flow Movements*

When an SPV rating is arrived at using the infrastructure and project financing criteria, Ind-Ra does not consolidate all SPVs under the same parent. This is because; normally, the SPVs' financing document has a predefined cash flow waterfall mechanism. Only the residual cash flows (the balance after satisfying all the project and debt requirements) of SPVs are available and distributable only when all the covenant conditions are satisfied and when there is no event of default existing. Also, in some structure, movements of cash flows among entities require lenders' consent rather than a framework which can guide automatic movement of cash flows. Where the consent of lenders or any other parties are involved, procedural risk will also be assessed. When such is the case, an unconditional consolidation of SPVs may not necessarily be possible through the lens of covenants.

However, if projects have neither a specific escrow arrangement, nor a stringent waterfall and if their lenders treat all the projects as one unit and there are evidences of smooth funds flow between the entities, then a top line consolidation is feasible. Likewise, if the structure is such that there are mutual cross default clauses among all the SPVs; but the covenants are designed in such a way that only residual cash flows can be consolidated, the rating of the pool will be constrained; where fungibility of funds is not possible without testing of covenants according to the financial documents. In this case, the rating will be built over the base of the weakest SPV, giving benefit to fund movements depending on the cash availability.

While these are broad principles followed by Ind-Ra to analyse pool structures, it would also factor in the historical track record of the structure being followed, adherence of pooling history, common lenders etc in arriving at the final approach to the rating. (These are not necessarily exhaustive.)

In an InvIT structure, Ind-Ra would ideally look for enablers for top line/complete consolidation. The enablers are generally in the form of consolidated covenant testing, combined shortfall testing, 100% or majority ownership of the SPV by the InvIT, no or minimal external debt obligation in SPV level, free flow of cash among the SPVs – upstream and downstream - and similar other covenants.

Likewise, the disablers of consolidation include individual SPV covenant testing, significant external borrowing at SPV level (in InvIT) that leaves little to be upstreamed, and restricted cash flow movements through covenants. The presence of these characteristics would result in a residual consolidation approach.

## Complete Consolidation –Enablers

- Cash flow shortfall testing on a consolidated basis rather than at the SPV level
- Consolidated covenant testing
- In case of an InvIT structure, absence of external debt at the SPV level
- Extent of InvIT holding in the SPV (100% is superior)
- Free Cash flow
- Mutual default covenants including cross default clauses among all the SPVs
- Commitment to distribute only after meeting all obligations of InvIT and entities under it

Let us take an example of three SPVs that have the following cash flow profile in a particular year

Figure 1
### DSCR Analysis

| Particulars (INR million) | SPV A | SPV B | SPV C |
|---|---|---|---|
| Revenue expenses | 10,000 | 6,000 | 8,000 |
| O&M expenses | 800 | 800 | 800 |
| Other costs | 500 | 500 | 500 |
| Taxes | 600 | 400 | 500 |
| Cash available for debt service | 8,100 | 4,300 | 6,200 |
| Debt service | 6,000 | 4,200 | 5,000 |
| DSCR (x) | 1.35 | 1.02 | 1.24 |
| Residual cash available (assuming a no lock up situation) | 2,100 | 100 | 1,200 |

Source: Ind-Ra

Figure 2
### Top Line Consolidation

| | |
|---|---|
| Total revenue expenses | 24,000 |
| O&M expenses | 2,400 |
| Other expenses | 1,500 |
| Taxes | 1,500 |
| Cash available for consolidated debt service | 18,600 |
| Consolidated debt service | 15,200 |
| Consolidated DSCR (x) | 1.22 |

Note: tax is a summation since SPVs are independent taxable entities
Source: Ind-Ra

## Residual Cash Flow Consolidation

In the residual cash flow consolidation, the revenue amount available from A is INR2,100 million, from B is INR100 million and from C is INR1,200 million. This will be available based only on the frequency of distribution as quoted in the financial agreements. For example, if this is available after testing of the covenants once a year; the usability of this surplus for shortfall in other pool constituents may not be credit-supportive. Therefore, the cash flow waterfall mechanism and the frequency of distribution and testing may constrain the credit significantly. Also, if the DSCR or other financial covenants fall below the threshold in the agreements, the utility value of pooling is unlikely to be high or even moderate. Therefore, these covenants could constrain the rating of the pool.

As against the above, if the structure and the covenants differentiate between residual cash flows and inter-company/inter SPV cash flow movements and explicitly states that the testing covenant does not apply to inter-company cash movements, credit would be given to such structures in the rating. The extent of notching will be based upon the projected free cash available to the projected shortfall under the base case and stress cases.

The cases given above are two extremes and Ind-Ra expects most cases of pooled/obligor-co-obligor structures and InvITs to fall within these extremes.

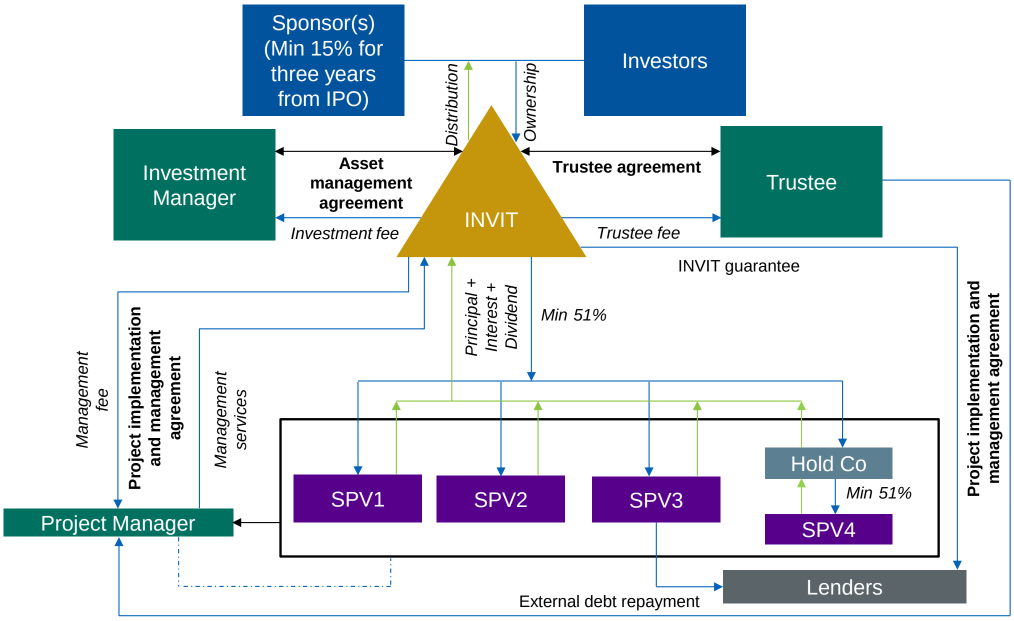
Approach that will be adopted. These are inclusive in nature and not exhaustive.

### SPV/constituent Level

- Existence of external debt at the SPV level
- Internal debt and their features
- Risk analysis at SPV level including Financial analysis
- Coverages including DSCR, LLCR, PLCR and other financial ratios at asset level
- Maintenance and operating risks
- Lock up covenants, Distribution covenants and other restrictive covenants
- Covenant testing and frequency of covenant testing
- Frequency of distribution
- Financial flexibility to move funds to other constituent SPVs – side streaming/upstreaming/down streaming etc – Whether these are covered under covenants
- Cross default/cross guarantee among other constituents in the pool/program
- Cross default clauses between the external debt of the InvIT and the external debt of the constituent SPVs
- What could constrain the SPV from contributing to the pool
- Taxes and other contingent liabilities
- Leverage levels in SPV
- Reserving requirements
- Revenue contribution/CFADS contribution to the pool
- Internal borrowing documentation and how is it positioned vis-a-vis external debt

Analysis Specific to InvITs

Figure 3
**Typical Structure of InvIT and Fund Flow Diagram**

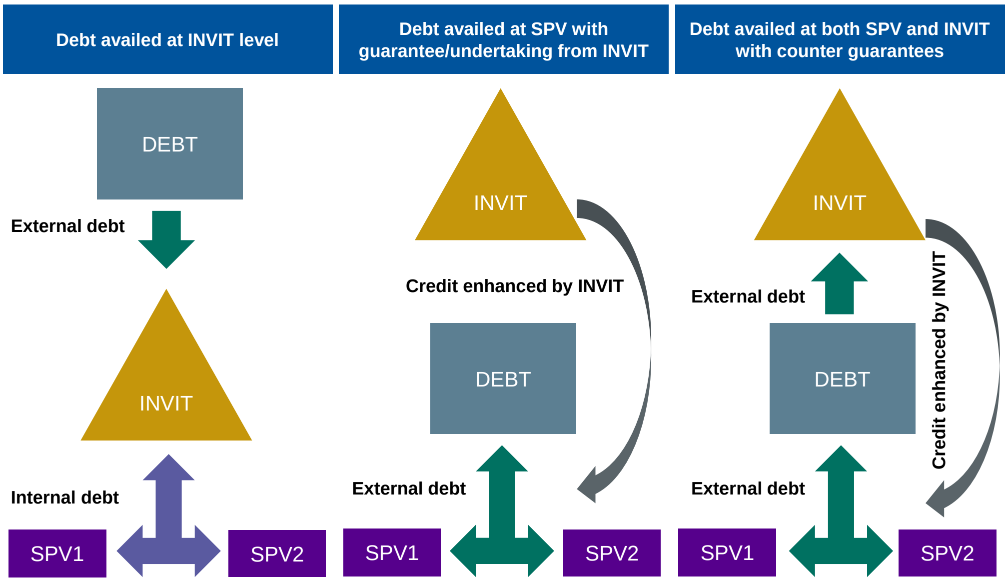



Source: Ind-Ra

There are the following three broad categories of InvIT borrowings:

1. External debt in InvIT and down streaming to SPVs
2. External debt in SPVs' books and no borrowings in InvIT
3. Hybrid – both InvIT and SPVs having external borrowings

Figure 4
**Debt Residence and Principles of Credit Enhancement**




Source: Ind-Ra

**1. External debt in InvIT and down streaming to SPVs**

In this case, Ind-Ra analyses the entire system as one single unit. The debt down streamed to SPVs can be senior or junior in nature and this decision may not impact the rating of the InvIT, provided it does not have any cross default clauses with senior debt; nor any event of default. This makes a strong case for top line consolidation. (Taxes and statutory liabilities will be computed for individual SPVs.)

**2. External debt in SPVs' books and no borrowing in InvIT**

The SPV's/SPVs' debt structure is analysed and the covenants of the SPV's external debt are analysed to examine to what extent top line consolidation is possible. The mutual/cross default clauses in each of the SPV's debt document and InvIT's declared methodology of calculating net distributable cash flows at SPV level and InvIT level will affect the decision to do top line consolidation. Distribution to unit holders only after meeting all dues towards all external debt obligations of InvIT and all entities under it is a necessary enabler for cash flow consolidation. Distribution policy is generally present in InvIT's offer document and any adverse change in the same will be evaluated for impact on the cash flow available for debt servicing across entities under InvIT. The extent of senior external debt in the SPV's books is factored into the analysis. The free cash available (residual cash flows) that can be upstreamed to the InvIT, will be factored into the analysis. If just one SPV has borrowing and neither the InvIT nor the other SPVs have external debt, it will be treated similar to point 1 above.

**3. Hybrid – Both InvIT and SPV having external borrowing**

Ind-Ra analyses the debt documents of SPVs and InvITs and the possibility of mutual technical defaults if any and the amount of free cash flows that will be factored into. Less number of restrictive clauses relating to dividends and upstreaming from the SPVs and commitment of InvIT to meet its cash flows for debt servicing for itself and all the entities under it before distribution could provide a consolidation advantage to the InvIT.

In the cases above, Ind-Ra would arrive at the ratings of the SPVs (for external debt of the SPVs) using the master/sector-specific criteria. There is no need to restrict the rating of InvIT to that of the SPVs. This is because the diversity, structural strength of the pool as a single unit, the pooling benefit and similar other factors will have to be accounted for in the InvIT's rating. Ind-Ra considers the ratings of SPVs as different from that of InvIT and vice versa.

In cases 2 and 3 above, if the debt servicing at any level could be at risk due to a weakest significant SPV/project, the presence of restrictive covenants across InvIT and entities under it preventing free fund movements to mitigate the risk from the weakest significant project, the credit profile of such an entity might constrain the rating of InvIT.

Assessment of the quality of revenues and other risks will be done using the master criteria/specific sub-sector criteria. This report gives guidance as to how the decisions are arrived at that concerns consolidation and ways of assessment of the pool.

## Pool/INVIT Level

- Cross default in the consolidated borrowing documents
- Revenue/CFADS contribution from each of the SPV
- Guarantees and other covenants related to the constituents
- InvIT to SPV debt – Features and covenants
- Operation and maintenance expenses and life cycle costs- How are those managed at SPV level and at InvIT level – whether there are reserving mechanisms or it will be paid out of the pooled revenue from the year in which it has to be incurred
- How are statutory duties and contingent liabilities met if the particular SPV does not have adequate cash flows
- Concession payments – SPV level vis-a-vis InvIT level

## Cross Guarantee Mechanisms in relation to Cross Default Clauses

In analysing cross-guarantees in an InvIT or obligor-co-obligor structure, Ind-Ra will look at the following aspects, among others and accord importance in the ratings:

A. Is the debt obligation identifiable for a single unit or it is the debt of the pool?

   The debt of the pool will strengthen the mutual support aspect and lend strength than the debt that is identifiable constituent-wise. However, if there are connecting clauses among the SPV financing documents, it will be treated as a pool.

B. When does the guarantee get activated – Post default or pre default?

   If the guarantee is effective only after a default on the debt of obligations on the other entity, Ind-Ra does not ascribe any value to the cross guarantee.

C. Can the cash flow be moved from one SPV to the other before invocation of the guarantee in order to avoid a default situation?

   Such inter-company cash flow movements within the InvIT/pooled structure are advantageous from a credit perspective. These movements would avoid a default and funds can be seamlessly transferred to ensure that a default is avoided.

D. Is there adequate time to move the cash to other companies?

   The agency will look at the timelines of the funds movements and accordingly apply the rating approach.

E. Does the guarantor have to follow a fixed waterfall mechanism before the funds can be moved to the guaranteed SPV? In other words, can the funds be transferred to the other SPVs having shortfall only after servicing its own debt obligation?

   Restrictions such as possible cash movement only after servicing the obligation (such as creating MMR, O&M reserve, etc) of a particular SPV/constituent etc are constraining from credit perspective. If no major condition is attached to the movement of cash within the group (not as distribution or restricted payment), it is an advantage from a credit assessment view point since it has the potential to avoid a default for the whole group.

F. Is there a defined distribution covenant and is there covenant testing? For instance, if the distribution is annual; debt service of all the constituents are monthly, and the cash flows cannot move out of the guarantor-SPV in any other way. In such a case there is no way of cash flow movement and therefore the guarantee may be considered redundant.

In case of an InvIT, the analysis will take into account whether the constituent SPVs have an external debt. If it is so, with a defined waterfall mechanism for the debt, Ind-Ra factors in the residual cash flows of the SPVs after servicing the external debt as the available cash flows that could be upstreamed or side-streamed to other SPVs. In case of guarantees by such SPVs, only the residual cash flows after servicing the debt can be considered by virtue of the financing documents.

It is possible in certain structures that the financial documents relating to InvIT's external borrowing and the SPV's external borrowing may not recognise a mutual default. In those cases, Ind-Ra analyses the distance to a default of both the SPV and the InvIT. Even if there is no mutual default clause, the rating of the InvIT and the SPV may not be far from each other.

## Covenant Testing and Liquidity Analysis

Ind-Ra's analysis includes the detailed aspects of covenant testing and its impact on the approach to the rating.

It may be possible that consolidated covenant testing may be annual; but side streaming (movement of cash flows within the pool) may happen more frequently than annual and is permitted by the financial agreements. The intent of the agreement in this case is that it treats the entire pool as one single unit (from a debt service perspective). This is a solid case for top line consolidation (assuming no other restriction is imposed). However, if the agreement states that the covenant testing is annual; but based on individual SPVs, permits side-streaming more frequently than annual, the analysis will include restrictive clauses for consolidation and the treatment of such cash flows.

The liquidity analysis will also account for the approach – whether in the eyes of the financial documents, the pool is considered as one single unit or constituent-wise. However, if the financial documents permit fungibility of cash flows even before covenant testing, the liquidity analysis will take into account the consolidated approach.

The liquidity analysis will be different for top line and residual consolidation. This is because covenants in the financing agreement determine liquidity and distribution. So, for a residual consolidation, the approach will be to analyse the liquidity at the individual SPV level and then based on the covenants how much of liquidity of each SPV will be available to be upstreamed to the holding structure and side streamed to other SPVs. In case of top line consolidation, the liquidity analysis will take into account the free movement of funds among the entities. Basically, these are two extremes. There are multiple structures possible between the extremes and the liquidity analysis will be based on those structures and covenants.

## Rating Approach

In case of pools where the standalone profile is not too relevant and the assets/SPVs are connected through covenants and clauses that tend to consider the pool as one single unit, the rating is arrived at based on the consolidated profile and this rating will be reflected for all the constituents. In such a scenario, the rating of the pool/InvIT will be reflected as the rating of the SPVs. This is because the analysis takes into account the pool as one single unit including the cash flows of all the SPVs.

If the covenants do not connect the assets/SPVs, each of the constituents/SPVs' standalone/supported ratings will be arrived at. The pooled rating will be arrived at based on a notching up from the standalone profile of the SPVs, based on diversity of the portfolio and other merits available to the pool.

## Some Common Questions Answered

### Can the constituent SPV/SPVs' rating be higher than the pool/INVIT's rating and vice versa?

Both scenarios are possible. If assessed on a standalone basis (ignoring the mutual default clauses and cross guarantees), one or more SPVs can be stronger than the pool/INVIT itself.

In these scenarios, if the pool/InvIT has a number of weaker SPVs in the weightage and these are rated much lower, it is possible that the pool/InvIT's rating can be lower than a single or a group of stronger SPVs.

### Can the pool/INVIT's rating be higher than even the rating of the highest rated (if rated on a standalone basis) SPV?

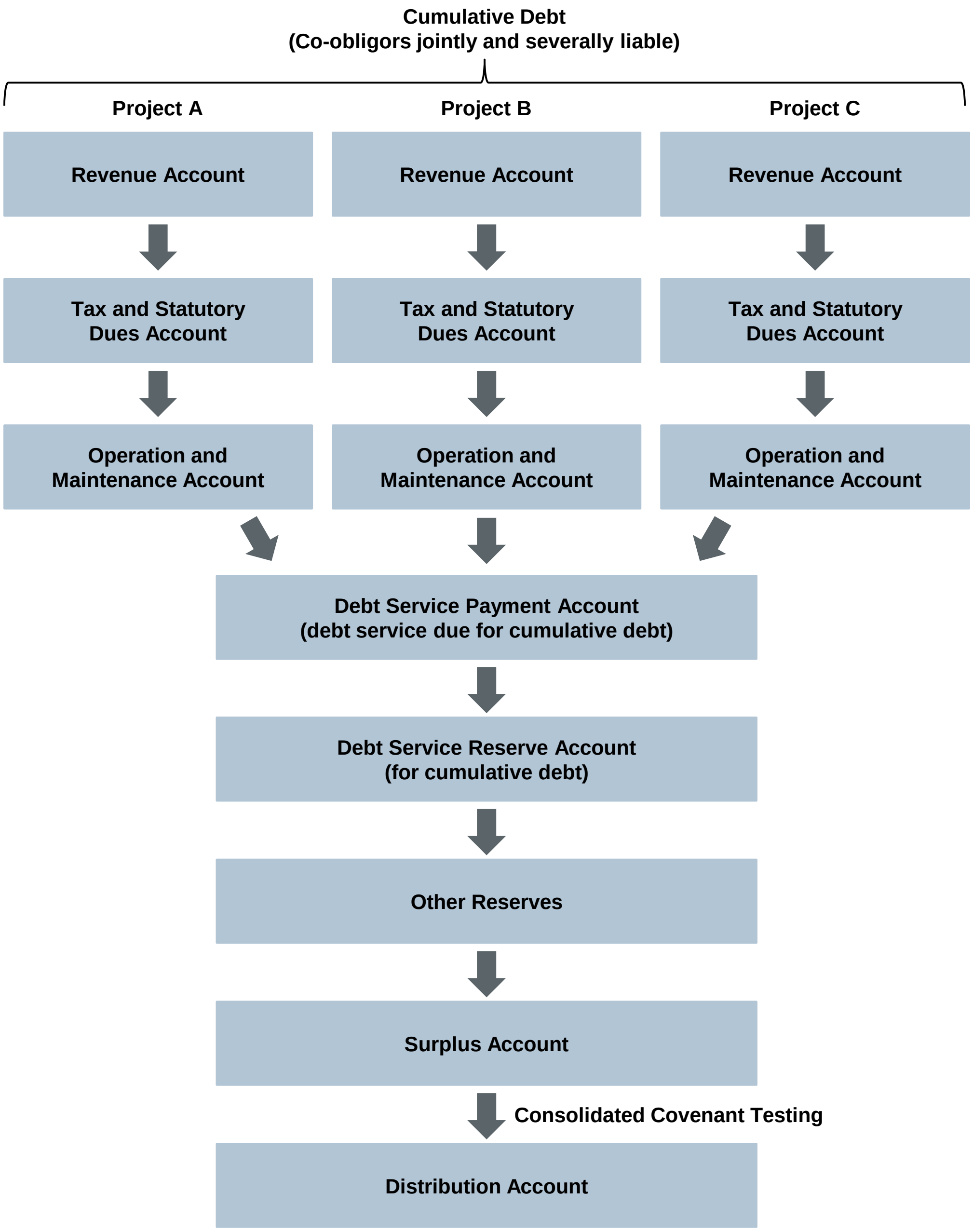
Yes. It is possible that the pool/InvIT's rating can be higher than the highest rated SPV in the pool. This is because Ind-Ra believes that the diversified and larger pool has the ability to withstand more stress and volatility than the individual SPV, however stronger it may be. Also, as stated elsewhere in this note, a consolidated position can be stronger than individual SPVs. The diversity of the pool, the ability to withstand combined stresses, the heterogeneous character of the assets, the regional diversification etc could carry the consolidated rating higher than individual SPV's rating.

### Aside of other factors, does the higher DSCR mean higher rating in such pools/INVIT?

It is true that higher coverages may lead to a better rating. However, it cannot be generalised. Ind-Ra's cases include the robustness of the coverages more than the coverages itself. Whether the project/pools have the volatility to withstand the robustness is tested. For example, a project having a DSCR of 1.30x may be rated lower than the pool that has a consolidated DSCR of 1.20x of which the said project is a part of. This is because, if there is volatility in the project, the DSCR of a single project will be affected more than it can affect the pool. The pool's DSCR may still not be affected by the volatility in a single project. Therefore, a pool with lower coverages can be rated higher.

On the other hand, it is possible that the pool/InvIT can have one or two entities which contribute significantly to their financial profile. Consequently, even if multiple entities are present, the pool/INVIT's rating may not benefit from diversification, which is a common expectation/intention when a pool/InvIT is created.

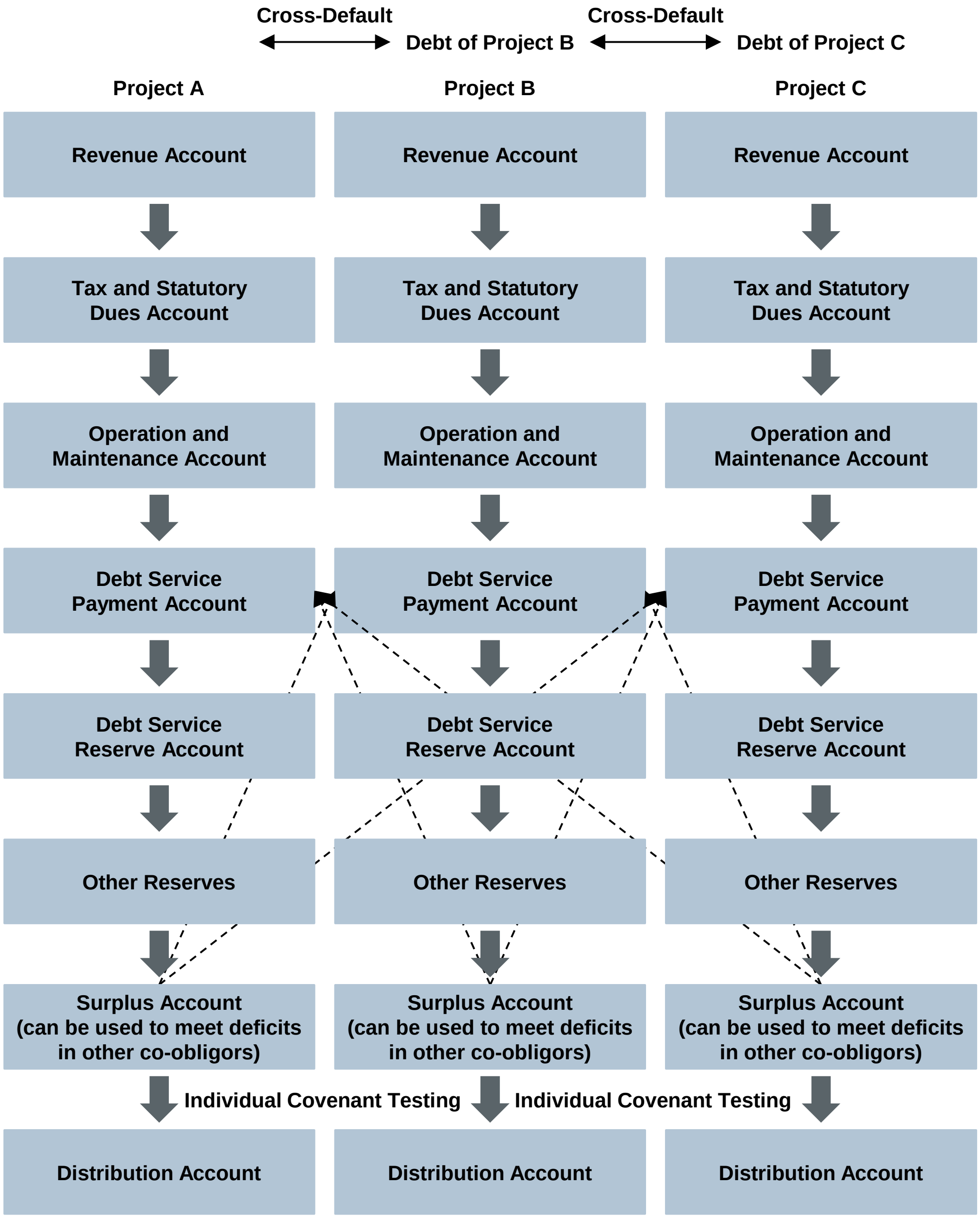
Figure 5
**Waterfall Mechanism of a Stronger Structure**




Source: Ind-Ra

Figure 6

**Waterfall Mechanism of a Weaker Structure**




Source: Ind-Ra

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