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Project Finance with predetermined lease for expansion of business

*Dr. Sanjeev Kumar K M.
**Prof. Mangalgouri S. Patil

INTRODUCTION

In this modern and competitive world, if any company has to sustain then improvisation and expansion is must. Company will not survive if the company is not going with the changing trend. There are so many reasons for that company is thinking to expand, like company will start the new product range or company is thinking about making a same product but in greater size or company want to increase the product quantity etc. But when any company is thinking to expand their business the first problem arise that 'from where we will get the finance for expansion'? So to solve this problem of the company, the finance manager has to do the project finance. So project finance is very important for any business who wants to expand their business. In expansion of business, companies issue some more shares to get funds, some companies put their own money, and some companies takethe loan from the financial institutes. There are so many methods to raise the funds. But companies always choose the path which is moderate, means which is neither too risky nor too safe. So most of the small and medium sized companies take 60-80% loans from the financial institutes and put 20-40% their own money. So how any financial manger decides to how much money should be taken so that it should not be too risky? For this financial manger does the project finance and forecast the company's financial position after 5-10 years so that company can decide if this project is feasible or not on the basis of finance. In project finance the manager decides how much loan should be taken, he also forecasts in how many years that new project will able to nullify the loan. Project finance is basically made on the basis of cash flow statement of the company. So this also shows the how much flow of cash will be happen because of this new expansion and is this new expansion project is feasible or not. So to learn the term project finance and how it is made is very much important for finance student rather it is a need for finance student. Maharashtra Industrial Development Corporation's is a project of the government of Maharashtra. MIDC provides businesses with infrastructure such as land, road, water supply, drainage facilities and street lights. MIDC provides land forbusiness on lease for 99 years but now they came with new lease policies as "Predetermined Lease" which is a tri-party agreement between MIDC, company and bank for those who take loan from bank.In this project I prepare the project finance and study the predetermined lease for the new project of "FINE SPAVY ASSOCIATES AND ENGINEERS PVT LTD", which is situated in MIDCMiraj, Sangli.

OBJECTIVES

- To prepare the project finance for new plant of the company.
- To study the "Predetermined Lease" for new plot in MIDC.

SCOPE OF STUDY

The research is vital to me in a significant way. It does have some importance for the company too. These are as follows:

- This research is a learning device for the finance student.
- Through this research I studied the various types of lease.
- The research is a learning of forecasting and planning of project financing.

PROJECT FINANCE

Project finance is long term financing of infrastructure and industrial projects based upon the projected cash flows of the project rather than the balance sheets of sponsors. Usually, a project financing structure involves a number of equity investors, known as 'sponsors', as well as a 'syndicate' of banks or other lending institutions that provide loans to the operation. They are most commonly non-recourse loans, which are secured by the project assets and paid entirely from project cash flow, rather than from the general assets or creditworthiness of the project sponsors, a decision in part supported by modeling. The financing is typically secured by all of the project assets, including the revenue-producing contracts. Project lenders are given a lien on all of these assets and are able to assume control of a project if the project company has difficulties complying with the loan terms.

The principle is simple: a bank finances a specific asset, and gets repaid only from the revenues generated by that asset, without recourse to the investors that own the project. It works well for project with well

*Department Of P G Studies and Research Mangement Karnataka State Womens University, Vijayapura, karnataka, India
**Sinhgad institute of management,Pune,Maharastra,India

identified assets with high initial investment costs, and strong cash flows after that, like big infrastructure items. International Project Finance Association (IPFA) defined project financing as:"The financing of long-term infrastructure, industrial projects and public services based upon a non-recourse or limited recourse financial structure where project debt and equity used to finance the project are paid back from the cash flows generated by the project."

LEASING

The technique of leasing gives the facility to possess and operate the asset without owning the asset. It is a method of financing where huge capital outlays are substituted by periodical rental payments. Under typical leasing transactions, a lessor acquires the title to the equipment to be leased by paying 100 per cent value for the asset identified by the lessee and then leases it out to the lessee under a lease agreement for a period normally less than the depreciable life of the asset. The Indian Accounting Standard – 17 defines a lease as follows:

"A lease is an agreement whereby a lessor conveys to the lessee, in return for rent, the right to use an asset for an agreed period of time."

Lease finance can be said to be a "Contract between lessor and lessee whereby the former acquires the equipment/ goods/ plant as required and specified by the lessee and passes on the goods to the lessee for use for a specific place and in consideration promises to pay the lessor a specified sum in a specified mode at specific interval and at a specified place."

Dictionary of Business & Management defines lease as – "Lease is a form of contract transferring the use or occupancy of land, space, structure or equipment in consideration of payment, usually in form of rent".

Lease agreements are basically of two types. They are i) Financial lease and ii) Operating lease. The other variations in lease agreements are iii) Sale and lease back iv) Leveraged leasing.

PREDETERMINED LEASE

Earlier whenever MIDC provides land to any business they used to make final lease. MIDC provides land to business at very cheap rate which is nearly half of market value of land. But some people buys that land from MIDC and they never start business on that land and after 3-4 years when prices are high they sold at market price to other. So the basic motto of MIDC which is "providing land to business at lower rate", that is not works. Because of this the real needy who want to start business, is not getting the land at lower rate in MIDC.

So MIDC changed their rules and type of lease also. Now who want to buy land from MIDC, they primary make only agreement with MIDC. In that agreement they have to submit their project report and building plan and in how much years they will complete their all building plans. Final lease will be made only after completion of plan and production of commercial products. And if business man fail to complete that then MIDC has right to take back that land, because in that agreement ownership of land is not transfer to the business.

But now in this case business man was facing problems. If business man wants to take loan then bank will not give loan on mortgage of land, because ownership of land is not transferred. That's why now MIDC come up with the middle path that is "predetermined Lease".

In predetermined lease there is a tri party agreement between MIDC, bank and company. So if business failed to complete their plan in said time then MIDC give that land to some other business and give the money to bank so bank can recover their money.

So because of predetermined lease the main motto of MIDC is fulfilled and also the business man gets money from bank.

DOCUMENTS REQUIRED FOR PREDETERMINED LEASE:

- Online application form on MIDC website with paper seal.
- Water department NOC.
- Service department NOC.
- Banks sanction letter of loan approval from Bank of Baroda.
- Building plan approval from engineer and estimate officer.
- Blank stamp paper of Rs 500/- in the name of 'Regional officer MIDC Sangli'.
- Company's Pvt. Ltd. sanction letter by company's Director's.
- Undertaking on Rs 100/- stamp paper by Director of company.

VII. STEPS FOLLOWED BY COMPANY FOR EXPANSION OF FACTORY:

When any business want to expand in MIDC area then that company have to go through some procedure which was establish by MIDC. It is not like that you wake up and want to expand and MIDC will give land for that. There is some procedure to follow some rules and regulations were made. Example if company want land for expansion then the current land's FSI must be used more than 60%. So these are some steps company gone through for expansion of business:

 New plot –

- Plot No – D 85/1 MIDC, Miraj.
- Application for acquiring new plot in DIC Sangli.
- Existing details of old plot have to submit in DIC Sangli. For expansion min 60% FSI should be used by company in old plot.
- Submission of technical report of expansion in "Technical Evaluation Department" in MIDC office, Mumbai.
- Application of approval to "Fire Department".
- Application of approval to "Environment Department".
- Allotment letter received by MIDC office, Mumbai.

As per following rate:

Rs 800/-……….Rate/m2
Rs 80/-……….Surcharge for road attached plot.
Rs 880/-
*6056…………area of plot in m2
Rs.56.05 lacs.

 Bank –

- Quotation
- Project
- CMA report
- Queries

All these activities were done in Bank of Baroda Branch Sangli and Head of Department Loan of Bank of Baroda Branch Goa.

 Predetermined Lease – DIC Sangli.
 Bank Agreement
 R.O.C.

VIII. COST OF PROJECT:

Particulars	Rs. In Lacs
• Leasehold Land	56.02
• Factory Building	322.90
• Electrical Material	12.50
• Machinery	190.21
• Furniture	14.00
• Miscellaneous tools,tackles	8.00
• Professional fees	2.00
Total Rs.	605.63

Means Of Finance:

• Own Contribution	155.63
• Term Loan From Bank	450.00
Total Rs.	605.63

Cash credit limit of 150.00 Lacs and Bank Guarantee limit of Rs. 50.00 Lacs is required for meeting working capital requirement.

ASSUMPTIONS:

The projected financial statements are prepared on the following assumptions:

The new unit is expected to be operational in the year 2016-17. Sales for the year 2015-16 are expected to increase at the rate of 10% and 70% incremental sales are expected in the year 2016-17 with the new unit sales.10% increase is proposed onwards. Approximately 45% of the total sales are expected to be export sale based on current experience of the company.

- Labour charges will increase @ 10% p.a. and 50% in the year 2016-17. Other expenses include administrative expenses, establishment expenses, taxes, fees, insurance etc. These are expected to increase @ 10% p.a. and 25% in the year 2016-17.
- Depreciation is provided on W.D.V. method, no depreciation being provided on land.
- The moratorium of one year is expected; during that period interest will be served. Foreign currency term loan for three years i.e. for year ended 31.03.2017, 31.03.2018 and 31.03.2019 is considered @ 5% p.a. and 12% p.a. interest rate is considered for other 2 years of term loan tenure. Interest on term loan during the moratorium period i.e. upto the commencement of production will be capitalized to fixed assets. Interest on cash credit is considered at the rate of 12% p.a. with 80% average usage of sanctioned limit.
- Cash credit and packing credit limit will be interchangeable totaling to Rs. 150.00 Lacs.
- Figures are rounded off to the nearest multiple of lakh.
- Provision for taxation is made at current rate applicable to company.

FINDINGS:

- As per projected balance sheet, profit and loss account statements it is clearly seen that the new project will run in profits.
- Positive cash flow indicates liquidity in cash and companies assets are increasing.
- Average DSCR ratio for years 2016 to 2021 is 4.11, so project will give appreciable profits.
- Predetermined lease makes leasing easier for MIDC, company and bank.
- Procedure of Predetermined Lease of MIDC is so much time consuming.

SUGGESTIONS:

- MIDC should make all procedure online of buying and leasing the land as time consideration.
- MIDC and bank should work fast as company will start new project as soon as possible.

CONCLUSION

The review of the projected financial statements read with the assumptions thereon, the satisfactory D.S.C.R. and the expertise, experience of the directors of Fine Spavy Associates and Engineers Pvt. Ltd., shows that the project is viable and feasible.

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