Summary of concerns over multilateral development bank funding for new model of infrastructure finance

A NEW FRONTIER IN INFRASTRUCTURE FINANCING
Analysis of Infrastructure Investment Trusts

A CASE STUDY OF ORIENTAL INFRA TRUST

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A new frontier in infrastructure financing: Analysis of Infrastructure Investment Trusts –

A case study of Oriental InfraTrust

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Anuradha Munshi, Gaurav Dwivedi & Kate Geary
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Introduction

20 October 2022: Centre for Financial Accountability (CFA) and Recourse released a new report, *A new frontier in infrastructure financing: Analysis of Infrastructure Investment Trusts - A case study of Oriental InfraTrust*, which raises red flags about a risky new form of financing for infrastructure. Known as InvITs (infrastructure investment trusts), these new vehicles are being used to refinance existing infrastructure, such as roads and energy projects.

The new report looks at a recent case study in India, where the Oriental Infra Trust (OIT) InvIT bundled five existing road projects and secured investment from international financial institutions (IFIs): the International Finance Corporation (IFC), Asian Infrastructure Investment Bank (AIIB) and the German DEG.

The AIIB and IFC boards approved over US$150 million into the OIT in 2018, intending for this new mode of financing to become a blueprint for future infrastructure investment. They were joined by the German development finance agency DEG in 2019, which provided a further 34 million Euros in equity. The AIIB stated that its aim was a “demonstration of a proof-of-concept that infrastructure investment trusts are a new type of financing vehicle”, while IFC stated, “Successful financing of the Project would demonstrate the feasibility and sustainability of large scale de-risked infrastructure assets in the country. The InvIT structure has a potential to be replicated in various other sectors in India and could help in attracting investments from large pension funds and insurance companies.”

The report calls into question the role of IFIs in supporting this type of investment, especially as they hope to replicate it more widely. Investing in infrastructure is particularly high risk, given the potential for large-scale resettlement, destruction of forests and rivers, impacts on communities’ livelihoods and exacerbation of gender inequalities. For this reason, IFIs have put in place environmental and social protections to ensure their investments do no harm. The problem with the InvIT model is that, because the banks only become involved after the projects are built, these vital protections were not applied during construction.

To green light financing into an InvIT, such as OIT, the shareholders of the IFIs must believe a created fiction - that the standards to which they are committed can somehow be applied *in retrospect*. Our report questions whether this is possible: a question banks must address before they continue to expand this new financing model, bringing further harm to communities.

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2 Deutsche Investitions- und Entwicklungsgesellschaft
Infrastructure investment trusts: A new model of financing

There has been a fundamental shift in infrastructure financing over the last two decades. Before the global financial crisis of 2008, it was more common for International Financial Institutions (IFIs), such as the World Bank and Asian Development Bank (ADB), to fund infrastructure projects such as roads and power plants directly. Since the 1990s, this has included facilitating an increasing role for the private sector through public-private partnerships (PPPs) to deliver projects the state used to provide.

In the wake of the global financial crisis, increasingly, IFIs began to channel their funds not directly to projects but indirectly via financial intermediaries (FIs), such as private equity funds or commercial banks. This move saw the advent of a trend for the creation of infrastructure as an asset class. The private sector became a more important actor in not only building and operating infrastructure, but also financing it.

In the decade from 2010, the ADB increased its FI lending tenfold; at the European Investment Bank and European Bank for Reconstruction and Development, FI investing has grown to over a third of their total portfolios today; while at the International Finance Corporation (IFC, the World Bank’s private sector lending arm), FI lending comprises over half of total spending. In India, private investment in infrastructure tripled from 2005 to 2009, reaching $159 billion, and by 2012, the Indian government was predicting that 50% of its energy finance and 70% of transport infrastructure finance would come from the private sector.

Now we are witnessing a further shift, adding a new layer to the investment chain that ends in roads, power, and other forms of infrastructure. Essentially, InvITs allow for the monetisation of existing infrastructure: they construct a bundle of infrastructure PPPs as an asset class (an asset class is a grouping of investments that exhibit similar characteristics and are subject to the same laws and regulations). This latest shift – of IFIs funding infrastructure investment funds - could open yet another era in private finance mobilisation: that of monetising PPPs as investments – in other words, bundling existing projects together under a trust as a means to earn further revenue. This marks another step in the financialisation of aid, and a step further away from direct IFI project oversight, involvement and application of standards.

The risk with InvITs is that with an even longer investment chain, the chance of IFIs ensuring protections are applied is diluted yet further. This is in fact part of the model: to ‘de-risk’ private investments, transferring costs to the state, citizens and nature in order to maximise profit.) Civil society has already documented the heightened risks of ‘outsourcing development’ through FIs, where a longer investment chain can end up divorcing projects from the environmental and social protections IFIs are supposed to ensure. In FI investing, the IFI delegates responsibility for assessing and managing social and environmental impacts of sub-projects to FI clients, with often disastrous results including forced evictions and other human rights abuses, forest destruction, environmental pollution disasters and destructive coal mines and powerplants. The remodeling of infrastructure as an asset class has attracted concern and criticism from civil society groups, with UK-based think tank, The Corner House, calling the new model a “platform for profit-seeking.”
Concerns:

Social and environmental impacts and application of standards in retrospect (see Annex)

In January and February 2022, an independent researcher visited villages along the route of the road projects (Nagpur Bypass project, Indore - Khalghat project and Nagpur - Betul project) to assess residual social and environmental (E&S) concerns. The research, which involved interviews with individuals, focus groups, review of local media, and interviews, revealed a number of ongoing impacts which call into question whether E&S standards and laws were upheld. The report details the environmental, social and economic impacts of the road projects, built in the last decade across the states of Madhya Pradesh, Karnataka, Uttar Pradesh and Maharashtra. These include carving up biodiverse forests, home to tigers and pangolins, flawed consultations, the displacement of indigenous people (known as scheduled tribes in India), safety risks, obstruction of access to public services, and problems with land acquisition and compensation.

Normally, IFIs would be involved in road projects in two ways: either through direct finance or, as is increasingly the case since the financial crisis, via an intermediary such as a private equity infrastructure fund. In both cases, the IFIs would require their environmental and social standards be applied before, during and after the project. Under the new investment trust model, the IFIs only become involved when existing infrastructure assets are bundled, in other words after projects have already been completed. Whatever
problems and harms were caused, happened before standards were in place since the project developers were not at the time required to uphold IFI protections.

To give the green light to IFI financing into an InvIT, such as OIT, the shareholders must believe a created fiction - that the standards to which the IFIs are committed can somehow be applied in retrospect. To do this, the IFIs commission a gap analysis through environmental and social due diligence (ESDD) reports, which identify which standards have not been met and how to mitigate that. The problems with this are twofold: first, the quality of the ESDD reports may be woefully inadequate, as in the OIT case - with fundamental information missing and scant one-day visits to affected people; second, there are some standards that cannot be applied after the fact: for example, Free, Prior and Informed Consent for indigenous peoples must be given before (prior to) project construction as well as during project implementation. This is not something that can be tackled on afterwards.

If IFIs are to expand further into this mode of financing – their stated intention - they must be able to address this simple question: how can they guarantee that their standards will be applied in retrospect?

Accountability

Linked to this issue of retroactive application of standards is the question of accountability. Unusually, despite the InvIT project being co-financed by both the AIIB and the IFC, the project is eligible for complaint to both the AIIB’s PPM and the IFC’s CAO. This is a rare exception to the AIIB’s usual policy of excluding co-financed projects: the AIIB has memoranda of understanding (MoU) in place with IFIs, such as the World Bank, European Investment Bank, Asian Development Bank and European Bank for Reconstruction and Development, to say that in the case of complaint, affected communities must approach the IAM of the lead financier’s accountability mechanism, not the AIIB. The exception is the IFC, which for unknown reasons does not have such an MoU with the AIIB. This means that, although the IFC is the lead financier, affected communities do have the right to file a complaint at both the Compliance Adviser Ombudsman (CAO) and the Project affected People’s Mechanism (PPM).

This anomaly results in a curious situation for the AIIB. Although as the lead financier, the IFC’s safeguards – the Performance Standards (PS) – apply to the project, the AIIB can nevertheless be held accountable for any failures in their implementation. Although the AIIB’s standards are largely similar or equivalent to the IFC’s, there are crucial differences. One of these relates to how the banks require their borrowers to relate to indigenous peoples – or in the case of India, scheduled castes and tribes. The IFC recognises the right of indigenous peoples to give or withhold their Free, Prior and Informed Consent (FPIC) for a project (PS7) in line with international law. The AIIB’s Environmental and Social Policy, however, dilutes this right to the weaker Free, Prior and informed Consultation (FPICon).

Such a distinction could be crucial for any complaint over the InvIT project, where Scheduled Tribes and Castes have potentially been severely affected, and whose consent was likely not gained for the acquisition of their land and property based on local people’s testimonies.

The IFC and AIIB are clear that in this project, the affected communities have the right to access their respective accountability mechanisms, the CAO and the PPM respectively. The compliance functions of the accountability mechanisms investigate whether an IFI has abided by its own standards (or in the case of the AIIB and the OIT project, the delegated IFC Performance Standards) in the preparation and delivery of a project. Hypothetically, if a scheduled tribe community were to file a complaint to the CAO and PPM, alleging that their right to Free, Prior and Informed Consent had been violated, the project developer, IFC and
AIIB could argue that standard (PS7) was not applicable when the road was built, and that therefore there is no violation. Even if non-compliance were established, how could a corrective action address this issue? It is not possible to gain someone’s consent in retrospect for a project already constructed.

Such fundamental questions around accountability must be addressed by IFIs if they wish to expand their use of InvITs to deliver infrastructure.

**Information disclosure**

Communities reported that there had been inadequate information disclosure at the time the road projects were constructed. However, beyond the immediate issue of project information disclosure – which should be assured under IFC PS 1 – the IFIs must address the critical issue of why disclosure about their decision to fund this project was delayed for two years. The Boards of both IFC and AIIB approved this investment in 2018 but did not inform the public about this until 2020. Why such a lag in disclosure? The access to information policies of both banks allow for such delayed disclosure in cases of commercial sensitivity. But to delay disclosure for two years on an investment which breaks new ground, where large, high risk infrastructure projects have caused harms to local communities, where there is allegedly post-facto application of environmental and social standards, where accountability is in question, is not acceptable.

**Inadequate due diligence**

The IFC hired consultants Mott MacDonald to provide a third party review of the five road projects, to determine whether the roads could meet IFC Performance Standards requirements. In March 2018, the consultants finished the first draft of their ESDD reports on the road projects, with final drafts not ready until September 2018 - months after the IFC and the AIIB took the decisions to approve over $150 million in development finance for the InvIT.

A review of the ESDD report for the Etawah Chakeri road, one of the roads with the fewest environmental and social impacts – for example, reportedly no indigenous peoples were affected – reveals a disturbing lack of evidence on which the IFC and AIIB boards took the decision to approve finance for the InvIT.

Mott MacDonald reviewed project documents and talked to the developers, local authorities – including forestry department and National Highways Authority of India staff – and visited two villages affected by the road on 19 January 2018. The 160 km stretch of road was converted into a six-lane motorway, with construction starting in 2013 and completed November 2016. NHAI acquired over 100 hectares of land for the road, compensating 103 villages for impacts, and affecting 7,461 land title holders as well as those without land titles, who are most likely undocumented.

The consultants concluded their review despite not having access to crucial information. Given their job was to determine whether the projects could comply with the IFC’s Performance Standards, it is difficult to understand how the consultants could do this. **It appears that they did not review the following:**

- the Environmental Impact Assessment,
- the Resettlement Action Plan
- Traffic Accident data
- Land acquisition data
- Details of the number of people physically or economically displaced by the road
- Records of community consultations
Details of compensation disbursed and received by project affected people
Annual environmental monitoring reports

Despite failing to obtain this crucial data, the consultants concluded that the project posed a “moderate risk” of non-compliance with the Performance Standards. A decision not to proceed with the investment can only be taken if the risk is categorised as high.

Recommendations

The reason that IFIs, such as the IFC and AIIB, have environmental and social standards is to provide protections for local communities and the environment, in order to prevent harm from projects. Infrastructure projects in particular, such as road projects, can have devastating impacts on local communities and biodiversity.

In this unusual case, these standards were not applied when the projects were built, and evidence presented in our report suggests that huge gaps remain between what those standards promise and what communities on the ground have experienced. In light of this, we call on the IFIs involved to:

- **Suspend any further IFI investments into InvITs** while concerns about application of standards, the balance of risks and benefits in public private partnerships (all five roads are PPPs), and wider social and economic impacts are addressed.
- **Launch an immediate investigation** into the harms caused by the five road projects, identifying where gaps exist between the Performance Standards and impacts on the ground. This investigation must be of sufficient quality, including extensive consultations with affected communities, and published in full;
- **Ensure full and fair redress for affected communities** who have suffered harm as a result of the road construction;
- **Develop lessons learned to inform future investments.** This must include consultations with civil society and take into account not just the economic context of InvIT investments, but their social and environmental impacts as well.

Shareholders of AIIB, IFC and DEG

Ultimately, it is the IFI shareholders and the Board members who represent them who decide both on whether an IFI’s policies are delivering effective development and who approve individual investment proposals. We call on the IFIs’ shareholders to:

- Ensure IFC, AIIB and DEG review the lessons learned from the OIT InvIT, provide adequate redress to affected communities, and suspend further activity as per the recommendations above;
- Reject any further InvIT project proposals until a wider policy review is carried out and the risks and challenges of InvITs are fully understood and addressed;
- Share lessons on the risks of InvITs with other IFIs’ shareholders;
- Reorient IFI policies and practices to deliver inclusive, sustainable and equitable investments that put people and planet at the heart of development.
Annex: Field research

In January and February 2022, an independent researcher visited villages along the route of the road projects (Nagpur Bypass project, Indore - Khalghat project and Nagpur - Betul project) to assess residual social and environmental (E&S) concerns. The research, which involved interviews with individuals, focus groups, review of local media, and interviews, revealed a number of ongoing impacts which call into question whether E&S standards and laws were upheld.

Along the Nagpur Bypass highway (NH-7) the researcher visited 11 villages and held interviews with 58 affected families. On the Nagpur Betul highway (NH-69) interviews were held in 10 villages with 37 affected families and along the Indore Khalghat highway (NH-3) interviews were held in 10 villages with 33 families.

Through these interviews and discussions local people revealed several problems related to project implementation, such as issues with land acquisition and compensation, impacts on indigenous communities, impacts on livelihoods, biodiversity and wildlife, as well as safety risks to the local communities, and access to public services.

Socio economic concerns

Roads and highway projects are land intensive and often require acquisition of large tracts of land, which include agricultural land, and forest land belonging to indigenous and marginalised communities.

Land acquisition

For the Nagpur Bypass highway, the total land requirement for the project was estimated to be 627 hectare (ha) out of which 243 ha was already available with NHAI. Fresh land acquired for the project was 384 ha, out of which 299.57 ha was private land, 52.93 ha is forest land and 31.50 ha was government land. Almost 51 villages were affected and 1,782 title holders were compensated by state government agencies. For the Etawah Chakeri highway, 160km of road, a contract was awarded in March 2012 to transform it into a six lane road. Construction began March 2013 and continued to November 2016. Over 100 hectares were acquired for the project and 103 villages received compensation by the state government. Over 7,000 land title holders were affected. For the Nagpur Betul Highway, 723.59 ha of land was acquired of which approx 40 ha was forest land. For the Indore Khalghat highway project a total of 520.03 ha of land was acquired of which 54.3 ha was forest Land. A total number of 1,278 households were displaced.

Local people in the villages alongside the highway suggested that the land acquisition process was marred by violation of due process. In certain areas people were not given sufficient notice for land acquisition. There are people who came to know about their land being acquired only at the time of acquisition.

Inadequate compensation

During the interviews conducted at the time of field visits, local people alleged that compensation was highly inadequate and not comparable to prevailing market rates. The project developers did not value agricultural lands accurately, with irrigated lands valued at the same price as non-irrigated. People who lost their agricultural lands, houses and shops, were not provided with livelihood rehabilitation, nor were people compensated for loss of crops, trees, wells, etc. Among those whose land was partially acquired, top soil was illegally taken for construction of the highway for which they were not compensated. In many cases, people’s land was not levelled and was left unfit for cultivation. People whose homes were partially or fully
demolished were not adequately paid compensation for the loss of their houses and were left to fend for themselves. This also affected people who were self-employed and had informal livelihood vocations. These people are now forced to work as daily wage labourers.

**Impacts on indigenous communities**

The Nagpur - Betul highway and Indore - Khalghat highway are built in areas with a considerable tribal population (indigenous communities). Many people belonging to the tribal communities have lost their agricultural land and houses to highway construction. There are serious questions on the manner in which their land was acquired despite there being special legal requirements for land acquisition in the case of tribal communities.

Indore - Khalghat highway land was acquired from two districts, Dhar and Khargone, which are so called Schedule V areas. The project impacted two tribal communities in the area – Bhils and Bhilalas. Both communities are categorised as Scheduled Tribes (ST). No Resettlement Action Plan or Indigenous Peoples Development Plan were prepared for the project. The Environmental and Social Due Diligence Report of the IFC clearly states, “The trigger for Free Prior Informed Consent in Indore-Khalghat section of the National Highway 3 was found relevant due to impact on ‘charnoi’ or ‘pastureland’. However, as the concerned project of widening an existing road required lateral expansion of the existing Right of Way (RoW), the loss of grazing land was small in quantity and the net loss of total pastureland available in the village was a small percentage only. Therefore, the impact on the pastureland is assessed to be insignificant. ST families losing land were paid cash compensation, but the impact on livelihood of ST families who lost land for expansion of the road was not assessed. Hence, the significance of the residual impacts and vulnerability of these households is not known.” Requirements for Free Prior Informed Consent (FPIC) have been clearly ignored on the grounds of insignificance of impact and absence of proper impact study.

The AIIB project documents claim that: “Interviews with the authorities, the NHAI and affected Scheduled Tribes, a review of land acquisition records and an assessment against the PS7 criteria have established that there are no significant residual impacts on the Scheduled Tribes from the land acquisition, resettlement, construction and operation of these two roads. It was established that the land acquired from the Scheduled Tribes did not reduce their access to resources or land under traditional ownership and customary use and the resettlement of a few households within their original village did not sever their access to any land or resources or alter the social structure of their communities.”

There are many cases where indigenous people affected by construction and land acquisition for the Indore - Khalghat Highway continue to suffer. Mahima devi (name changed), a 62 years old resident of Dhar district who belongs to the ST community, told the researcher that she has been living there with her two sons and daughter-in-law for 20 years. Her son had a tea shop on the road, but it was demolished during the construction of the road. She had the lease of the land where she lives. During the construction of the four lane road, her home and one bigha (12,000 sq ft) of land was acquired, but she said that she did not receive compensation. The road construction did not allow her to rebuild her house. With great effort and struggle, she built a small hut. After the land acquisition, the forest department has given the lease of some other piece of land to her, but the lease documents have not been provided as yet. She worries that when the construction of the six lane road will start, her home will be demolished again. Being on the side of the road, there is always a risk that a fast speeding vehicle may crash into the house. There is no electricity and water in the hut. And water has to be brought from far away.
Another person (name not disclosed) who belongs to the Bhil-Scheduled Tribe of Dhar district stated that his one bigha land was acquired for the construction of the road, for which a compensation of Rs 18,454 given to him was insufficient compared to the prevailing market rates. On his remaining three bighas of land, he had to build a house again at his own expense, since the compensation amount given was insufficient. He incurred a loss of Rs 40 to 50,000 per year from agricultural produce due to land being partially acquired.

Environmental concerns

Nagpur Bypass highway and Nagpur - Betul highway pass through important biodiversity areas, including wildlife corridors important to tigers and pangolins. The Nagpur Bypass road affects forest reserve land which is very important for critically endangered species, including tigers, pangolins and vultures. According to the IFC’s Biodiversity Action Plan: “A 37.45 km historical stretch of the Nagpur Bypass road passes through the Reserve Forest land and is mostly contiguous (over 22 km) with the buffer zone of the Pench Tiger Reserve, screened as Critical Habitat for the presence of two IUCN critically endangered (CR) species of vultures (Gyps bengalensis and Gyps indicus), and three IUCN endangered (EN) species, i.e., tiger (Panthera tigris), wild dog (Cuon alpinus) and Indian pangolin (Manis crassicaudata). A total of about 49.2 ha of reserve land, which would be categorized as natural habitat, has been diverted for widening to 4-lanes.”

The AIIB’s project document notes that all five roads have impacted forest land. It says that mitigation comprises compensation for felled trees, or replanting on areas double that taken for the roads: “The execution of these offsets rests with the forest department, while the NHAI is responsible for covering the associated costs and the identification of land suitable for planting trees.”

Given their potentially serious impacts on wildlife habitats and forest land, their construction required clearance from the National Board for Wildlife (NBWL) and the Forest Advisory Committee (FAC). Both agencies raised objections to the construction of the highway. Despite not getting this required clearance, the developers went ahead with the construction work. After a long legal battle, FAC approved the construction with the recommendation to implement several mitigating measures in the sensitive part of the state. This recommendation has still not been fully complied with. The construction of the highway and the increased traffic along with lack of proper mitigating measures, has resulted in an increase in the wildlife fatality, especially leopards and tigers.

Safety risks: accidents, fatalities, access

With heavy vehicular traffic on highways which cut across villages, there has been a considerable increase in road accidents, according to local sources. Absence of service lanes, overbridges and underpasses has added to the risk of accidents. A study commissioned for the IFC in 2018 found that fatalities on the section were very high: eg at the Nagpur Bypass in 2015 there were 173 accidents, of which 18 fatal, in 2016 173, 24 fatal, and in 2017 171, 22 fatal.

These are some of the concerns that were communicated by the local communities and authorities around the implementation of road projects. These need to be further investigated and adequately addressed by the implementation agencies and the financial institutions.
Image: Poorly constructed service roads

Image: Lack of waiting area, students having to wait on highway(NH-69)
Impacts of COVID-19 pandemic

The local people, who had already suffered due to the highway construction and the loss of land, houses and livelihoods, were again at the receiving end with the spread of the COVID-19 pandemic across the country. In common with many around the world, the people suffered loss of family members due to COVID-19. Reliable data on the impacts of Covid in the states is not available, so the scale of the impact is difficult to assess.

The local people said that the highways at many places are cutting across villages. This is affecting villagers' access to vital public services, which are now spread on two sides of the highway. With no way to cross the highways, which have heavy vehicular traffic, children’s access to school and *Anganwadi* (government supported free nutritional centres for infants and their mothers) has been affected badly. Villagers find it difficult to allow children to cross the highways on their own. During COVID-19 these *Anganwadi* centres were providing primary health services as well. The new highways became barriers for people and *Anganwadi* workers, preventing them from accessing or providing services.