

2008

PPP Projects – A Short Overview  
by Export & Project Finance

# Introduction

## Abbreviations

- Public Private Partnership ("PPP") or Private Finance Initiative ("PFI")
- ...are two names (with the same meaning) of an alternative financing method for public infrastructure investments

## Industries Suited for PPP's

- Accommodation; hospitals, schools, police stations, museums, prisons
- Transportation; roads, railways, subway systems
- Others; water and waste treatment facilities, military installations

## Existing EPF Exposures

- Schools: Bristol City Schools, Edinburgh Schools, Kent Schools
- Waste: ELWA, Lancashire Waste
- Hospital: Stoke Mandeville
- Other: Seeboard Powerlink and Danish National Archives (SEB MLA)
- Roads: ...more than one under review

# Structure

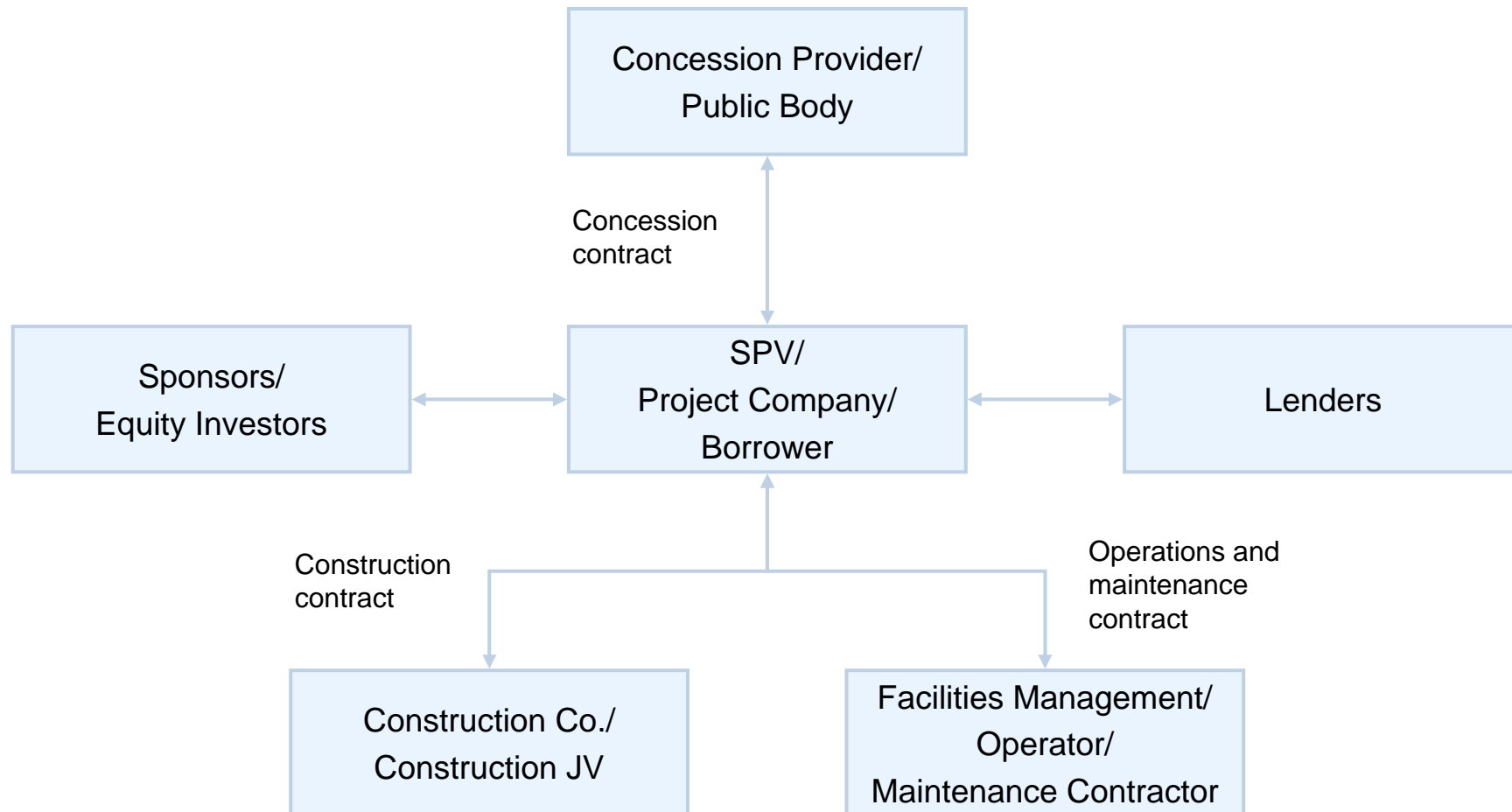
## Parties

- Public body – ministries, municipalities or counties
- Contractor – sometimes a joint venture and the contractor often invest equity
- Financial investor – specialized funds sometime invest equity
- Facilities management – operates the project post construction completion
- Lenders – often large bank syndicates due to large debt requirement
- Project Company – the SPV, Borrower or Concessionaire

## The Life of a Project

1. A public body requests offers for the construction and operations of an asset
2. SPV's bid and one company is awarded a concession for c. 25-30 years
3. The SPV signs contracts with construction co. and operating co.
4. The SPV negotiates bank funding, with tenor of concession minus c. 2 years
5. At completion, the concession provides for payments from the public body
6. Typically, such payments are based on the availability of the asset
7. Payments are used for debt service, operations and maintenance expenses
8. At maturity of the concession, the asset is handed back to the public body

# Structure, cont.



# Debt Financing

## Key Terms

- Very indicative capital structure; debt c. 90%, equity c. 10%
- Tenor equal to concession life minus a few years
- Repayment schedule sculpted after free cash flow and DSCR
- Security in all assets, contracts and accounts
- Risk of construction contractor or operator non-performance and/ or default mitigated through performance bonding, liquidated damages and guarantees
- Covenants include DSCR, LLCR and distribution lock-up clauses
- Events of default include a termination of the concession agreement, etc
- Margin - depending on e.g. risk of payments from the public, sovereign risk, leverage, track record and risk of construction company and liquidity costs

## Risk Class

- During construction – often same or close to the RC of the construction co.
- Post completion – often 0 to 3 notches below sovereign ceiling, depending on sovereign risk, the terms of the concession, leverage and payment structure

# Risks

## **Risks Typically Retained at Borrower/ SPV Level**

- Failure by contractor to complete the project, exceeding bonds/ avail. equity
- Failure by operator to manage the project, with more costly substitutes
- Failure to insure the project
- Omission by the project company
- Effect of changes in law not covered for in agreements
- Cost of insurances and excess on insurance, exceeding assumptions
- Life cycle maintenance expenses, exceeding assumptions

## **Risks Typically Allocated to Contractor, Operator, Public Body and Insurer**

- Reduction or elimination of demand for the asset (although sometimes for example motorway projects include an element of traffic risk)
- Delay in completion
- Cost overrun
- Force majeure

# Rationales

1. The private sector has certain advantages relative to the public sector, such as private sector management skills, the private sector can create synergies (design, construction, operations, etc) and is often more innovative
2. Tight fiscal policies and limited availability of public funds; hence “whole-life costing” through periodic availability-payments post completion (as opposed to large capital expenditures during the construction phase) are preferred
3. A PPP structure provides for risk transfer, from the public sector to the private sector, while the credit risk, from a bank’s perspective, is as close to public sector risk as practically possible (at least post completion)
4. Experience indicates that frequent problems encountered by construction projects (like cost overruns and delays) are not as frequent when a project is financed through a PPP structure, due to a number of reasons