

Project Finance of infrastructure PPPs : an introduction

Infrastructure PPPs : presentation

- **Definition :**

- Way of delivering public infrastructure through procuring services rather than capital assets
- Public sector defines service requirement
- Private sector designs, finances, builds, operates, (usually transfers) the asset

- **Interest**

- Alleviate budgetary constraints
- Expertise
- Transfer of risk

PPP Risk Matrix

Public procurement (building and/or operation)	Partnership agreement (building and/or operation)	BOT (building and operation)	Privatization (building and/or operation)
Public financing, public payment	Private financing, public payment	Private financing, private payment (users)	Private financing, private payment
Risks assumed by the private sector: construction risk	Risks assumed by the private sector: construction risk, performance risk	Risks assumed by the private sector: construction risk, performance risk, commercial risk	Risks assumed by the private sector: construction risk, performance risk, commercial risk
Degree of control by the public authorities: very high	Degree of control by the public authorities: high	Degree of control by the public authorities: low	Degree of control by the public authorities: very low

Project finance : presentation

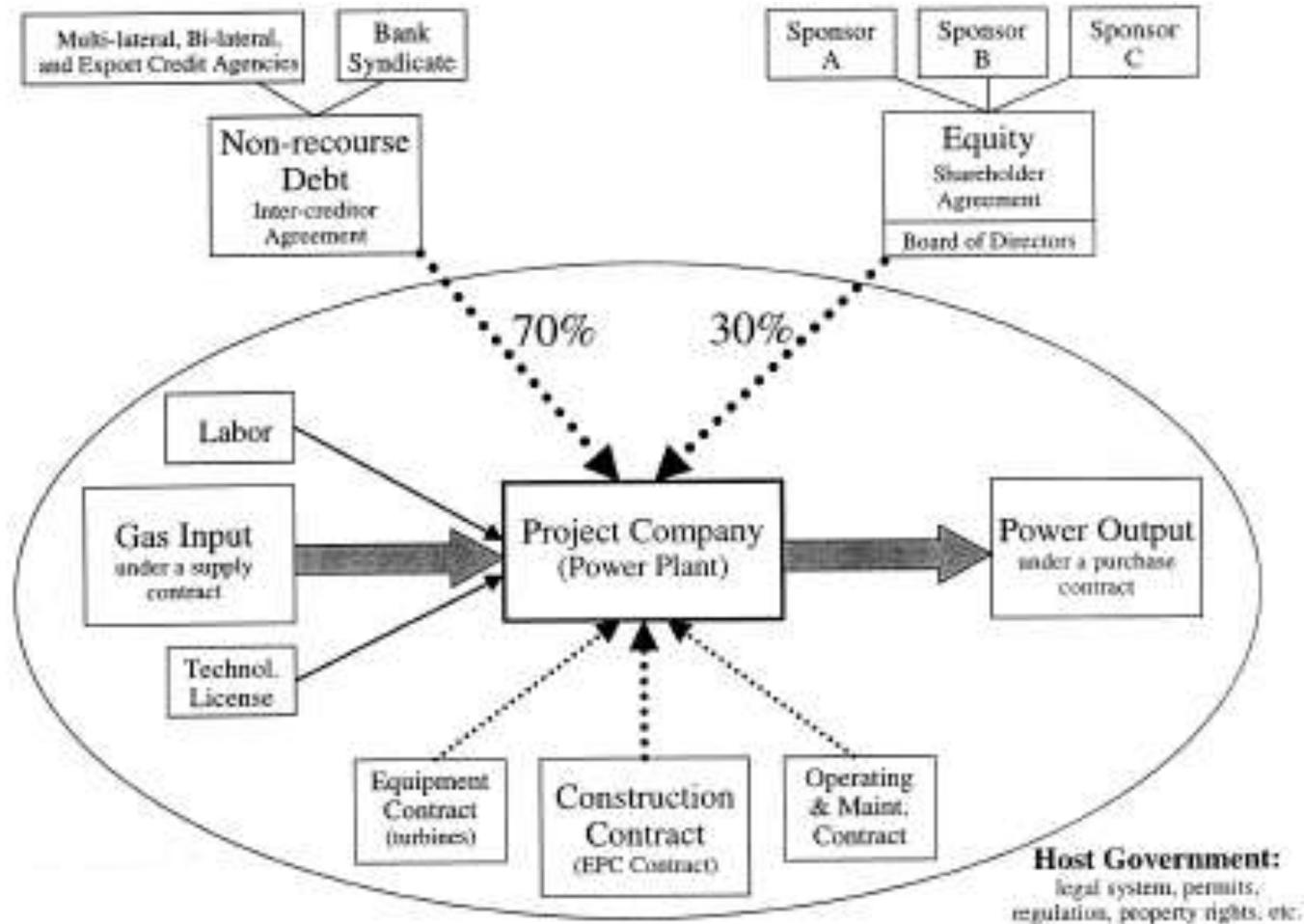
. Definition :

- **A stand alone project and a Special Purpose Company**
- **Non recourse MLT finance with high ration debt/equity**
- **Lending based on project cash flows**
- **Lenders mainly rely on project contracts as project security**

. Interest :

- **Transfer of risk**
- **Lower the risk**
- **Lower the cost/increase the return on equity**

An example of project finance structure



Source: Esty, B., "An Overview of Project Finance – 2002 Update: Typical project structure for an independent power producer"

A favourable institutional framework

. An adapted legal and regulatory framework:

- complete (PPP, public domain, securities, investment and preinvestment protection)
- clear (directly or indirectly : assistance and/or binding opinions)
- encouraging competition (transparency and remedies) and the diffusion of ideas (the private sector may contribute to the definition of the needs of the public party)

. A public expertise :

- Prior identification of the needs (budgetary, financial, operational, expertise, risk management) and of the objectives
- Negotiating capacity (internal and external)

A bankable project

- . A cash flow positive project :**

- Capacity to generate the cash flow necessary to repay the debt and constitute the necessary guarantees (even in a bad case scenario without jeopardising the continuity of operations)
- Capacity for the sponsor to fund the equity needs of the project

- . An experienced operator**

- . A mature technology**

- . A limited or covered political risk**

The PPP agreement (1)

- **Objectives, royalties and performance targets**
 - **The public party's undertakings:**
 - exclusivity,
 - occupation of the public domain,
 - permits and authorizations,
 - provision of essential utilities,
 - tax and customs regime,
 - payment obligation/offtake agreements/public subsidies,
 - right to distribute the proceeds and to free convertibility,
against expropriation,
 - reserving the rights of the lenders

guarantee

The PPP agreement (2)

- **Limitations to the private party's freedom of management :**

- approval of change of ownership,
- maintenance,
- insurance,
- approval of tariffs and possible IRR caps

- **Delimitation of the public party's rights :**

- right of approval of the works,
- status of the transfer of the assets at the end of the PPP,
- powers of control and of sanction

The PPP agreement (3)

- . **Unforeseeable events** : Hardship, force majeure : (allocation of risks, consequences, compensation)
- . **Public party caused changes** : change orders, change of law (conditions, consequences)
- . **Change of operator/change of operator/step in right**
- . **Refinancing** (conditions, consequences)
- . **Early termination** (General interest and breach of contract : compensation mechanisms)
- . **Applicable law** (impact on the PPP) **and settlement of disputes**
(mediation/arbitration/investment protection)

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Other major contracts : The main Financing documentation

- **Loan agreement**

- cash waterfall and use of Insurance proceeds

- financial and other covenants

- step in right

- acceleration

- **Security documents : pledge/mortgage/assignment of proceeds/escrow accounts/completion guarantees**

- **Direct agreement with the government**

- **Political insurance (as the case may be) :**

- scope/duration/possible State counter guarantee

Other major contracts (may vary depending on each project):

. Construction Contract (EPC):

- acceptance process
- delays and penalties
- performance guarantees
- liability caps
- insurance
- force majeure

. Operation and Maintenance Contracts:

- scope and conditions of intervention
- performance guarantee
- liability and insurance
- duration and termination

Other major contracts (may vary depending on each project) :

. Offtake Contract:

- tariffs
- take or pay obligation
- delivery conditions
- force majeure
- duration
- guarantees (state guarantees/political insurance)

. Input Supply Contract:

- tariffs
- take or pay obligation
- delivery conditions
- force majeure
- duration

Case study: a port BOT in West Africa

. Presentation :

- Local and regional demand**
- Solid sponsors**
- Existing local competition**
- Land belonging to various public entities**
- Exploitation of the sand by local population**
- Dredging necessary**
- Energy limitations**
- Perceived political risk**
- Applicable legislation does not allow for step in rights**
- Project to have significant employment and financial impact on the State's budget**

Case study: a port BOT in West Africa

. Project structuring :

- Local SPV set up
- IFC led consortium of commercial Banks
- sponsor's corporate guarantee for the construction period
- tenders for subcontracting
- Throughput agreement with a financially solid shipping company
- Changes in the legal regime to allow for (i) the independent production of electricity by the port operator and (ii) the

lender's step in right

- dredging undertakings and agency agreement for the port operator to contract the dredging company on behalf of the public authorities
- environmental report carried out and compensation regime set up for the local populations prevented from exploiting the sand on the new port's site
- Public land owned by several public entities contributed to the port operations by the sole Grantor
- Determination of the tariffs by the Port operator but on the basis of principles preserving the competitiveness of the port within the region
- Ruling by the tax authorities to ensure that specific tax and customs advantages open to the SPV may as well benefit the subcontractors