PPPs from the Private Sector's Perspective
A Banker's View

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What does a bank look for in a PPP Project?

- ❑ Equator Principles
- ❑ Strong political support and commitment
- ❑ Good public sector decision making process
- ❑ Sensible procurement process
- ❑ Acceptable level of risk
- ❑ Standard risk allocation and documentation
- ❑ English language preferred
- ❑ Minimum size threshold
- ❑ Good quality sponsor(s)

The Equator Principles

Adopted by most leading project finance banks

Projects have to be “developed in a manner that is socially responsible and reflect sound environmental management practices”.

All projects that have a material adverse environmental impact:

- ❑ Must have an Environmental Assessment done
- ❑ Must comply with minimum environmental standards
- ❑ Must comply with an Environmental Management Plan

The Equator Principles

A benchmark for the financial industry to manage social and environmental issues in project financing

Public Sector support

- Government support essential
    - Personal support from Minister
    - Finance Ministry must be in favour
- Cross-party support preferred
- Clear negotiating mandate to Project team with adequate delegated authority
- Ready access to ultimate decision maker (Minister/Department Head)
- Project team needs strong leader and commercial experience

Procurement process

- Selection must be transparent and based on sensible criteria
    - Pass/fail where criteria subjective
    - Ranking based on objective criteria
- No onerous conditions
    - Bonds/sureties, if required, must be proportionate
    - Limited recourse structure must be recognised
    - Late stage funding competitions de-motivate banks
- Timetable must be adequate and, ideally, kept to
    - Can still be rapid: 12-15 months
- Project and tender documents must be well developed

Level of risk

- Banks like bearing project risk
  - That is how we earn our money!
- But there are limits…
  - Banks have no upside
  - Interest margins now under 1.00% p.a.

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Why is assessing the risk of PPP projects like the search for weapons of mass destruction?

"… as we know, there are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns - the ones we don't know we don't know."

Donald Rumsfeld
US Secretary of Defence
12 February 2002

Why is assessing the risk of PPP projects like the search for weapons of mass destruction?

NOT because risks don't exist!

- Known knowns – risks allocated to third parties
  - Authority, sub-contractors, insurers, swap providers
- Known unknowns – risks banks can assess
  - Creditworthiness of these third parties
  - Market risk, where well diversified (e.g. toll road usage)
- Unknown unknowns – risks banks can't assess
  - Behaviour of significant parties not covered by contract
  - Extreme events (e.g. Force Majeure)

Standard risk allocation and documentation

- The UK OGC Guidance is widely used, at least as a guide to risk allocation
  - Familiar, so shortens negotiations
- There should be no significant deviations that favour the public sector
  - But no need to be cautious
- Banks will accept usage/market risk, but at a cost
- Payment mechanisms should not be overly complex
- Documentation in English, as international language of business

Key issue is what happens on default termination

- Termination should not be too easy!
  - No “hair trigger” events
  - Need opportunities to remedy
- Banks need step-in rights under Direct Agreement with awarding authority, suspending termination
  - “Win-win”, as authority gets comfort that banks will try to rectify problems
  - Step-in conditions must not be too onerous
- If termination does occur, fair compensation should be paid for net value of project assets

Project size

- Banks' work does not increase much for bigger projects
- Minimum threshold of c. € 50 million to be economic
- Threshold can be lower where there is a sizable programme of similar projects
- No need for caution in early projects
  - Very substantial amounts can be raised for good projects, even in new markets

Private sector sponsors

- Sponsors bear much project risk through sub-contracts and equity finance
  - Need to be creditworthy
  - Relative credit standing affects finance terms
- Banking relationships are important, and affect finance terms

Hence:

- Separate tender for finance may not be value for money
  - competitive construction price may be more than offset by poor credit standing

Banks are bidding aggressively for good projects

In strong Investment Grade countries:

- ❑ Interest margins down well below 1.00% p.a.
- ❑ Tenors out to 30 years
- ❑ “Tails” down to 12 months
- ❑ Debt service cover ratios down to 1.15:1
- ❑ Debt:equity ratios above 90:10