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Commercial and Financial Structures for PPP Projects

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Introduction

What are the best practice commercial & financial structures that should be applied to PPP projects?

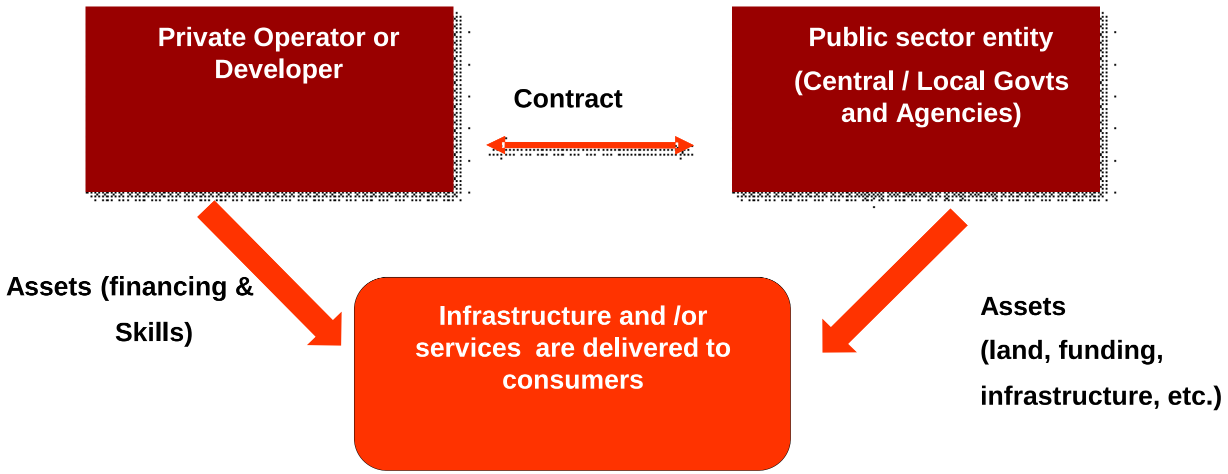
- What type of commercial structures are best for the different types PPP projects?
- How should a PPP project be funded?
- What is the ideal funding structure for each type of PPP project?
- How long should a PPP project run?

No clear cut answer……it just depends!

Overview of PPP Transactions

The key word in PPP is "Partnership"….

- A PPP is any ***contractual relationship between public and private sector parties*** where they come together with ***aligned goals to provide public sector services***, using the guiding principle that the ***inherent risks are allocated to those parties best able to manage them***, and to ***deliver better value for money for the public purse***.



PPP projects offer various benefits but also present a number of challenges…..

Benefits

- Require the public sector to focus on outputs and benefits from the start of the investment process
- Allow for the quality of assets and services to be maintained for the life of the project
- Encourage the private sector to invest in public sector infrastructure projects and services
- Help the public sector pay for services that are delivered
- Maximise the use of public and private sector skills and expertise
- Allocate risk to the party that is best able to manage them
- Deliver budget certainty as contract prices are locked in

Challenges

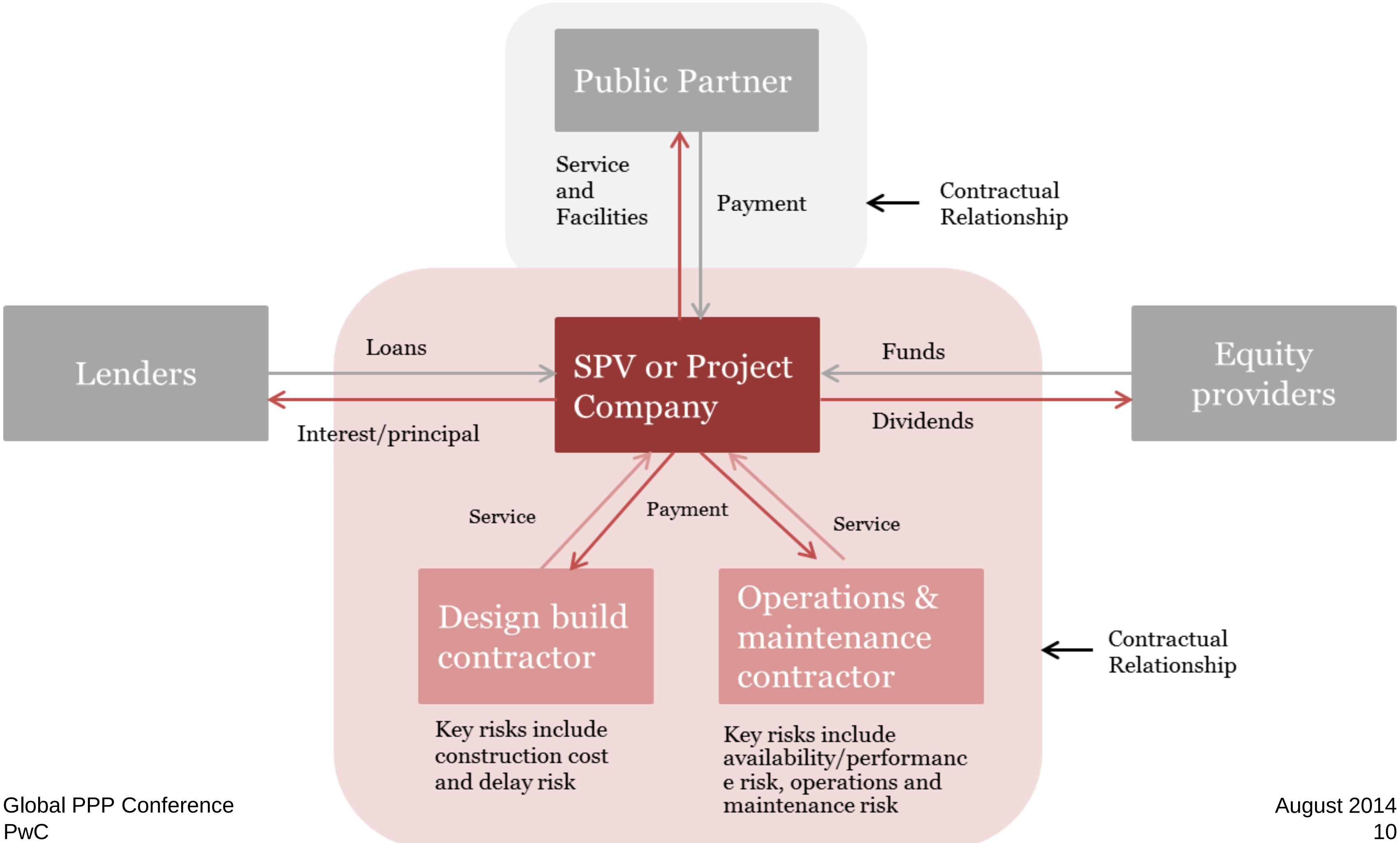
- Creating a long-term commitment that may create fiscal rigidity
- Changing the role of the public sector from delivering services to monitoring the services delivered
- Reducing the level of control that the public sector has over the asset.
- Length of the procurement process
- The higher cost of capital for the private sector needs to be factored into the contract structure
- The public may take the view that private companies are receiving too large of a return on the projects, at the taxpayer's expense
- PPPs do not eliminate risks or achieve absolute risk transfer

Commercial Considerations in PPPs

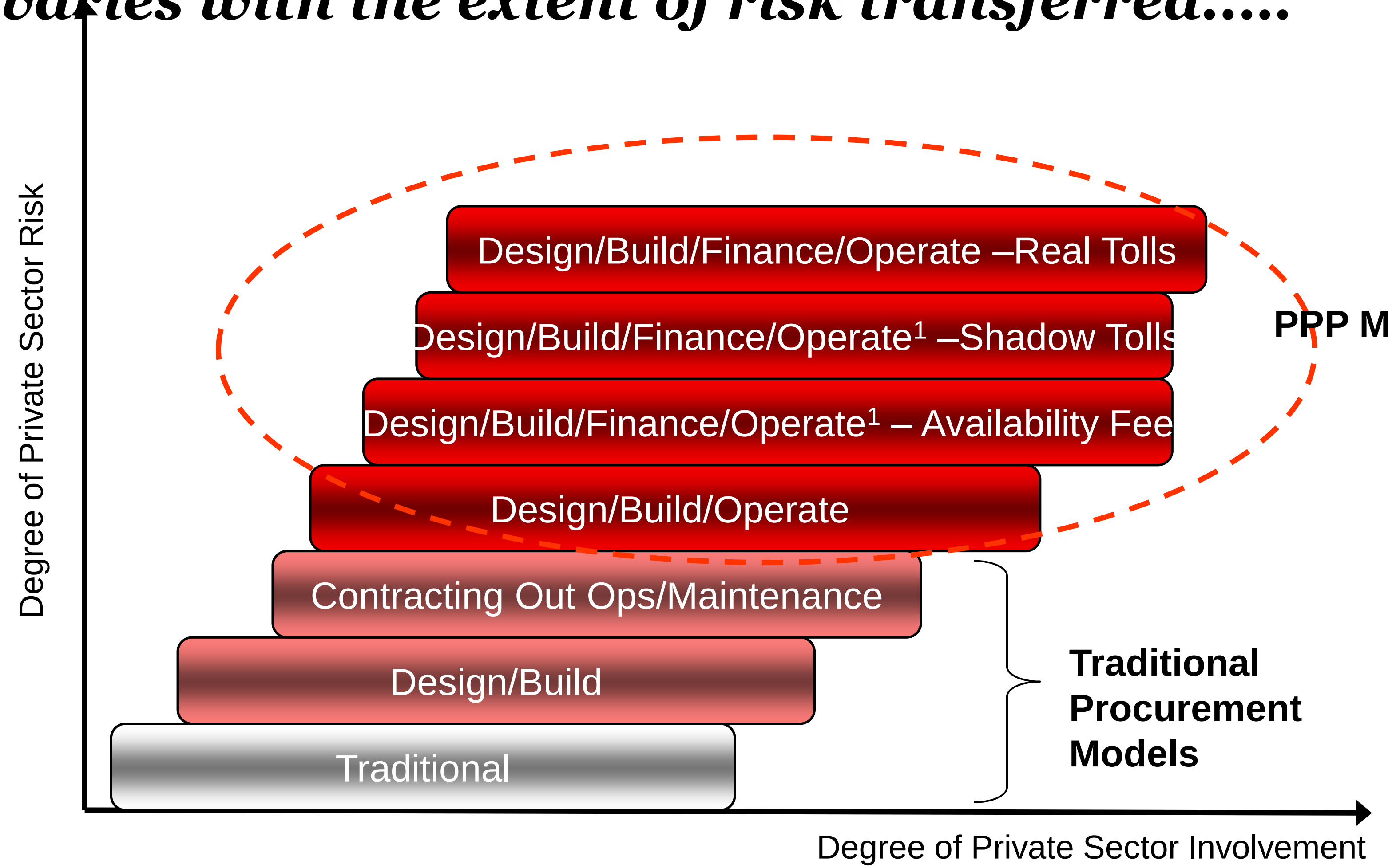
The key commercial considerations in PPPs revolve around effective risk allocation…

Examples of Area of Risk	Description
Demand Risk	Risk of traffic/ demand falls short of projections
Right of Way/Sites Risk	Risks related to condition and title, land use, encroachment etc
Planning Consent/Concession Risk	Timely and effective grant of all the necessary consents (including legal, regulatory, land-use, environmental etc.)
Technical Risk	Potential faults in private party's proposed changes to design etc.
Construction Risk	Risk of delay in completion or failure to meet performance criteria.
Operating Risk	Risk of change in cost for implementation, delays or interruption in service, shortfall in service quality etc.
Financial Risk	Fluctuations in interest rates, fluctuations in inflation rates that leads to the value of payments being eroded, fluctuations in exchange rates etc.
Force Majeure Risk	Risk of floods, riots, strikes, etc.
Regulatory/Political Risk	Changes in the law, changes in the regulatory regime, political interference such as breach of contractual provisions, import restrictions, discriminatory taxes etc.

A typical PPP structure allocates risk to the party best equipped to manage those risks……

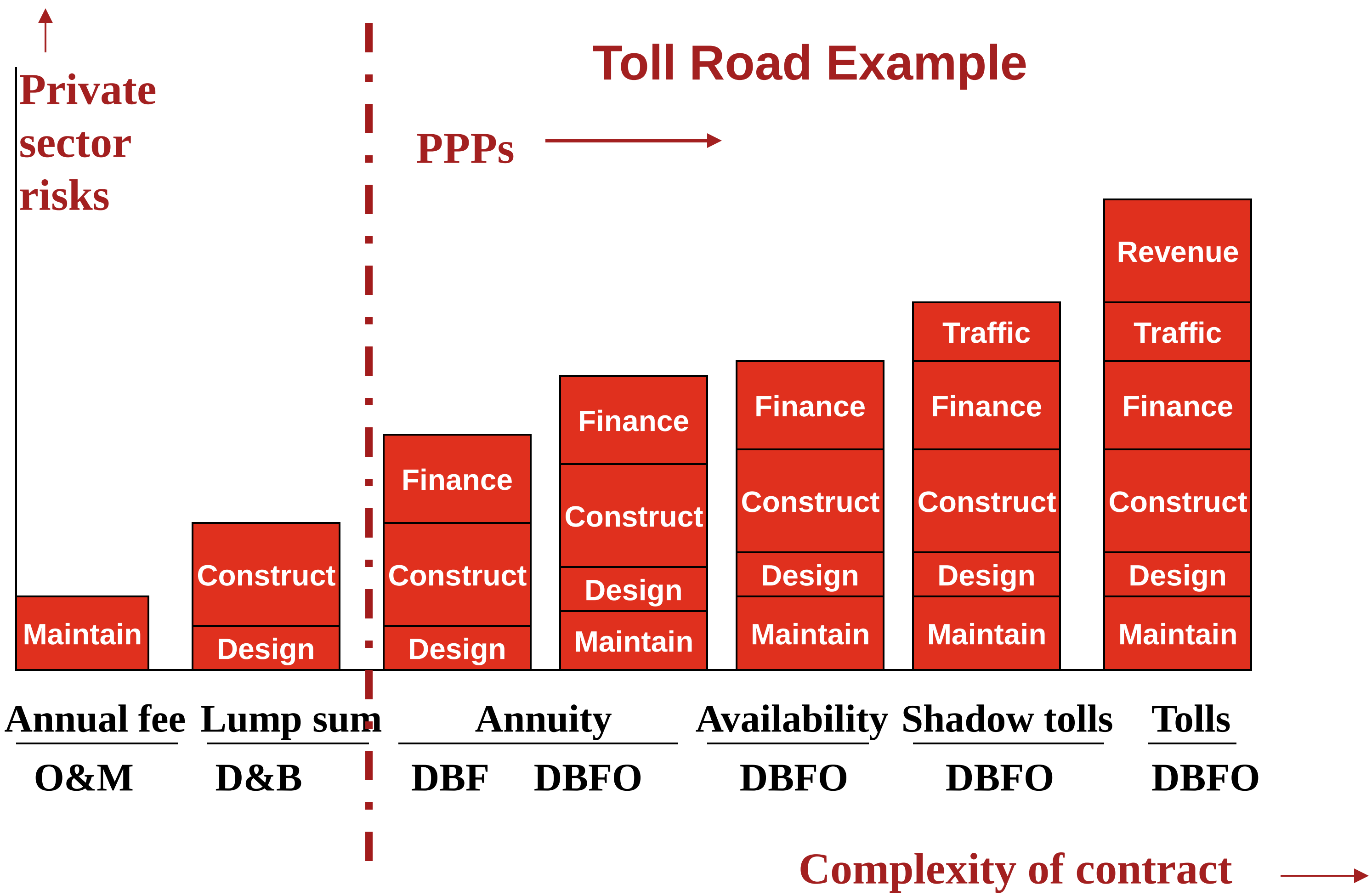


The method of remuneration to the private sector varies with the extent of risk transferred…..



[1] Alternate structure may just include maintenance responsibilities and not full operations including maintenance

The complexity of commercial structure increases with level of risk assumed by the private sector…



Government support is sometimes required to achieve/improve commercial viability….

Government support may be needed to

improve commercial viability

Grants/subsidies

- land acquisition
- provision of ancillary facilities
- capital grants
- concessionary loans
- subordinated loans
- revenue support
- tax relief

reduce project risks

Guarantees

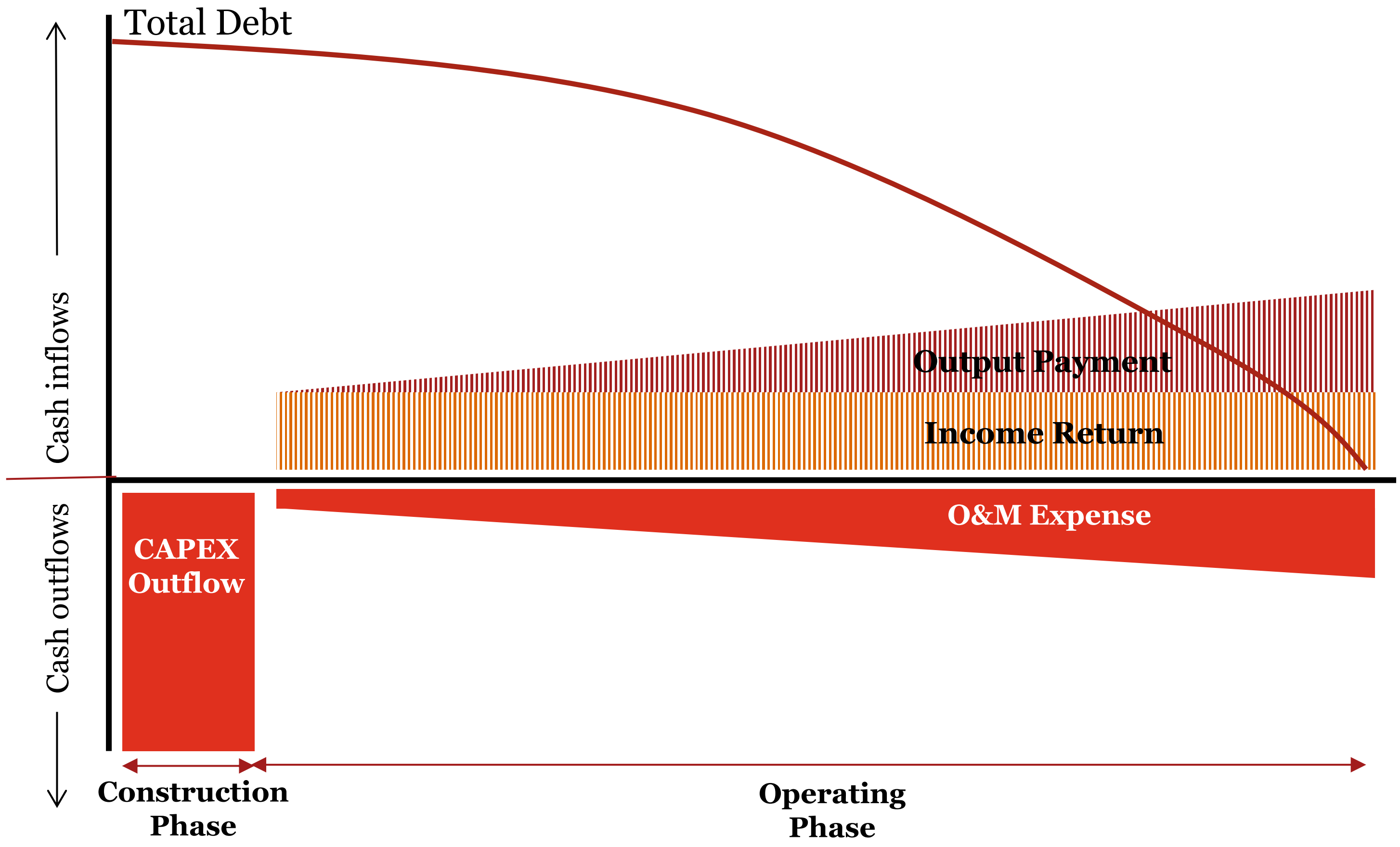
- equity guarantees
- debt guarantees
- “step-in” rights
- exchange rate guarantees
- traffic/revenue guarantees
- concession extensions

Financial Considerations

There are a number of options to finance PPP projects…

- ***Government funding*** – government may fund while private sector contributes expertise to construct, operate and maintain
- ***Corporate or 'on-Balance Sheet' Finance*** – private partner may fund using own resources (typically for lower value projects)
- ***Project Finance*** – most commonly used financing structure for large infrastructure PPP projects, may include
  - ✓ Bank debt
  - ✓ Bonds
  - ✓ Private placements

Typical Cash Flows of the ProjectCo



Some considerations that impact on financing include…

- ***Equity contributions*** – lenders will typically require some equity contribution from project sponsors in order to demonstrate sponsors' commitment to the project and incentivise other parties
- ***Debt Service Coverage*** – lenders will require comfort that the ProjectCo will be able to absorb shocks in service phase
- ***Debt structure and ability/requirement to refinance*** – e.g. deferred payment obligations, senior/subordinated debt, inflation linked bonds, requirement to refinance during concession period etc
- ***Reserves* –** lenders will typically require debt service reserve holding at all times, typically about 6 months of interest and principal payments

Other considerations that impact on financing include…

- ***Country risk*** – incl. extent of government intervention and support for PPPs, the degree of economic and political stability, as well as contract enforceability and the integrity of the legal system
- ***Legal and contractual framework*** , incl:
  - ✓ Contractor replacement and step in rights
  - ✓ Provisions for dispute resolution
  - ✓ Ranking of security against funds lent
  - ✓ Restrictions on activities of ProjectCo and related entities
  - ✓ Restrictions on dividend distributions in the event that DSCR falls below an agreed level

Summary

The most appropriate commercial & financial structure depends on the specifics of each project

What type of commercial structures are best for the different types PPP projects? ***Depends***

- How should a PPP project be funded? ***Depends***
- What is the ideal funding structure for each type of PPP project? ***Depends***
- How long should a PPP project run? ***Depends***

One size does not fit all……seek professional advice!

PwC Credentials

Our record over the last decade

Project Finance International – Global closed deals

Global by number of closed deals for 10 years to 2012

Rank	Adviser	No. of deals	Value $'m
1	PwC	333	99,041
2	Ernst & Young	247	63,347
3	Macquarie	171	83,599
4	KPMG	156	55,421
5	Grant Thornton	103	10,577
6	HSBC	96	91,474
7	BNP Paribas	58	43,172
8	SBI Capital	54	31,252
9	Royal Bank of Canada	53	25,243
10	Citigroup	46	42,874

Source: Project Finance International, January 2013

Global by value of closed deals for 10 years to 2012

Rank	Adviser	Value $'m	No. of deals
1	PwC	99,041	333
2	HSBC	91,474	96
3	Macquarie	83,599	171
4	Ernst & Young	63,347	247
5	Royal Bank of Scotland	63,245	32
6	Credit Agricole	58,073	10
7	SG	55,666	43
8	KPMG	55,421	156
9	Mizuho	48,358	13
10	BNP Paribas	43,172	58

Source: Project Finance International, January 2013

1st globally with 333 closed deals for 10 yrs ending December 2012

1st globally with closed deals value of $99,041m for 10 yrs ending December 2012

Our record over the last decade

Project Finance International – EMEA closed deals

EMEA by number of closed deals for 10 years to 2012

Rank	Adviser	No. of deals	Value (US$'m)
1	PwC	246	65,276
2	Ernst & Young	191	42,681
3	KPMG	118	30,794
4	Grant Thornton	103	10,577
5	HSBC	63	62,364
6	Macquarie	62	23,951
7	Royal Bank of Canada	41	17,970
8	SG	32	34,958
9	BNP Paribas	30	28,251
10	Royal Bank of Scotland	29	48,832

Source: Project Finance International, January 2013

* excludes ineligible deals under the $20m threshold

EMEA by value of closed deals for 10 years to 2012

Rank	Adviser	Value (US$'m)	No. of deals
1	PwC	65,276	246
2	HSBC	62,364	63
3	Royal Bank of Scotland	48,832	29
4	Ernst & Young	42,681	191
5	SG	34,958	32
6	Citigroup	33,012	25
7	KPMG	30,794	118
8	BNP Paribas	28,251	30
9	Macquarie	23,951	62
10	Natixis	23,632	16

Source: Project Finance International, January 2013

1st with 246 closed deals in EMEA for 10 yrs ending December 2012

1st with closed deals value of $65,276m in EMEA for 10 yrs ending December 2012

Thank you for your attention