Conventional Finance vs PPP

ENPI H2020 CB/MEP Course

Amman, Jordan

December 19-21, 2011

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Finance of Projects

The following series of slides address various finance options and their structures:

- Public Finance
- Corporate Finance
- Project Finance

Conventional Public Finance 1/

- Governments fund public projects by using existing surplus funds or issuing debt (government bonds) to be repaid over a specific period. Contracts that follow this type of project execution are the usual Engineer and Procure Contracts (EPC).

- A government borrows funds to totally or partially finance an infrastructure project. Naturally, Government may contribute its own equity in addition to the borrowed funds to reduce the total debt.

- In order to borrow, a government gives a sovereign guarantee to lenders to repay these loans. This sovereign guarantee then shows as a liability on Government's list of financial obligations, thus affecting its credit rating.

Conventional Public Finance /2

- Lenders analyze Government's total ability to raise funds for repayment of the loan through taxation and/or general public enterprise revenues, including new tariff revenue from the project, i.e. through taxpayers or users, or both

- Donors may impose certain covenants pertaining to the utility or entity benefiting from the project which could be timely or otherwise. International lending or development institutions may, rightly or otherwise, dictate certain terms that go beyond the project itself

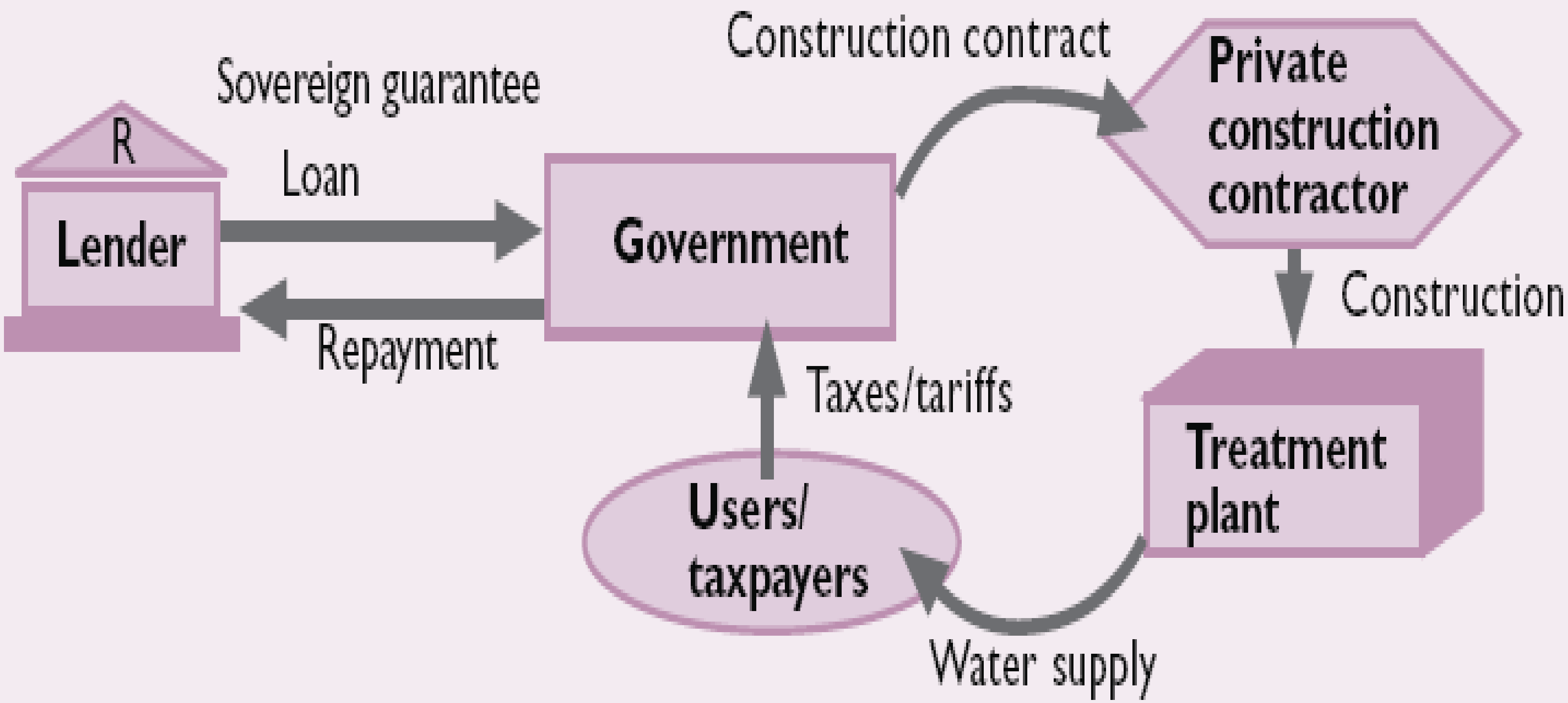
- Though still needed when assessing the magnitude of the portfolio of projects needed to be financed, this funding is less attractive as it taxes already strained government own balance sheets limiting its ability to undertake other projects

Public Finance

- Governments use existing surplus funds or issue debt (government bonds) to be repaid over a specific period. Contracts that follow are EPC.
- A government borrows funds to totally or partially finance an infrastructure project. Government may contribute its own equity to reduce the total debt.
- A government gives a sovereign guarantee to lenders to repay these loans. This sovereign guarantee then shows as a liability on Government's list of financial obligations, thus affecting its credit rating.

Public Finance Structure

(Source: Project Finance Manual, National Treasury South Africa 2001)

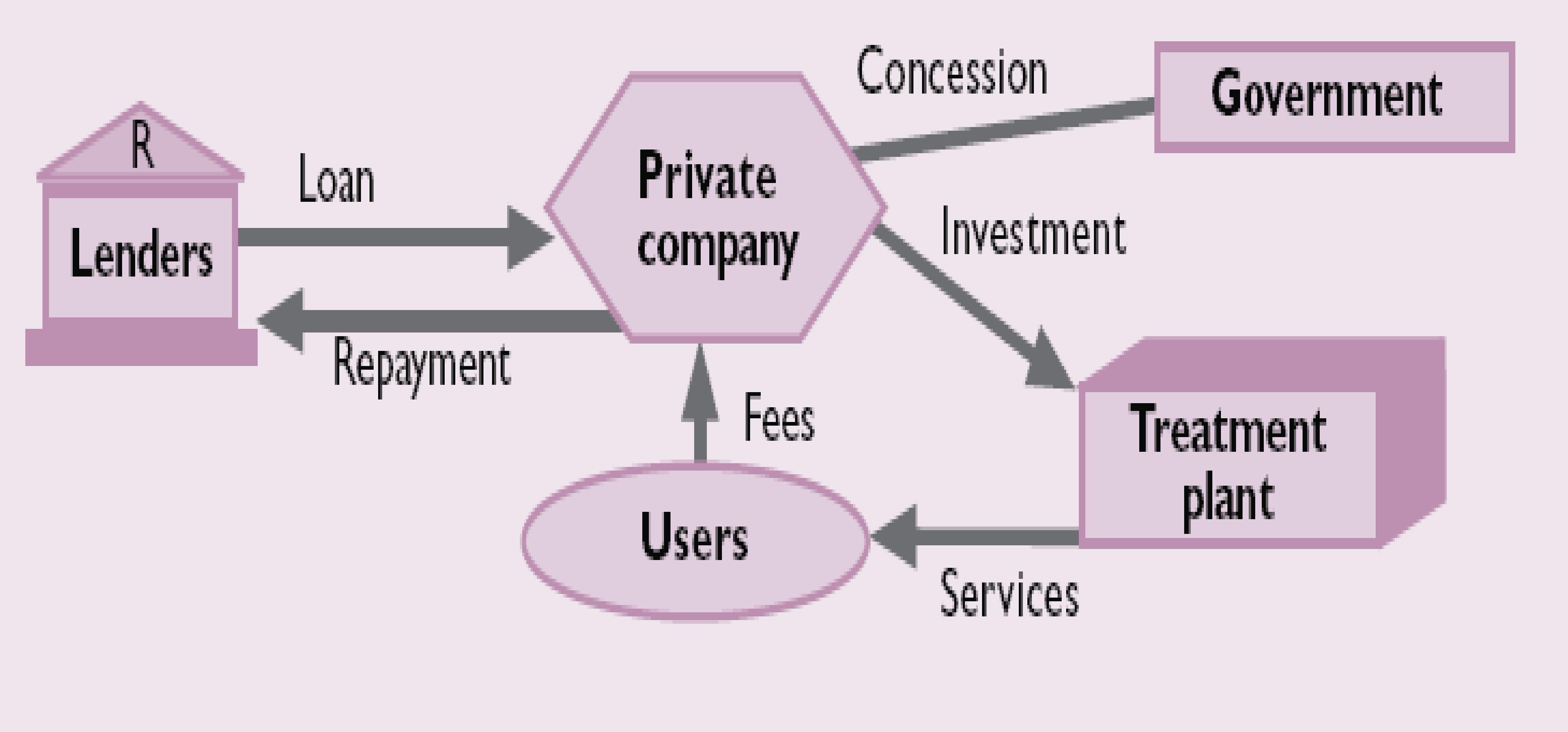


Corporate Finance

- Corporate Finance is used for shorter, less capital-intensive projects that do not warrant outside financing.
- A private company borrows funds to construct a new treatment facility and guarantees to repay lenders from its available operating income and its base of assets.
- The company may choose to contribute its own equity as well.
- In performing credit analysis, lenders look at the company's total income from operations, its stock of assets, and its existing liabilities.
- The loan shows up as a liability on the company's balance sheet
- Generally, however, private companies avoid this option, as it strains their balance sheets and capacity, and limits their potential participation in future projects.

Corporate Finance Structure

(Source: Project Finance Manual, National Treasury South Africa 2001)



Project Finance
1/4

- Project Finance uses the project's assets and/or future revenues as the basis for raising funds.
- The sponsors create a special purpose, legally independent company (SPV) in which they are the principal shareholders.
- SPV usually has the minimum equity required to issue debt at a reasonable cost, with equity generally ranging between 10% and 30 % of the total capital required for the project.
- Individual sponsors often hold a sufficiently small share of the new company's equity, to ensure that it cannot be construed as a subsidiary for legal and accounting purposes.
- The final legal structure of each independent project is different.

Project Finance

2/4

The legal vehicle (company) frequently has more than one sponsor, generally because the project exceeds the financial or technical capabilities of one sponsor:

- The process requires or encourages a joint venture with certain interests (e.g. local participation or empowerment).
- The sponsors complement each other in terms of capability.
- Risks associated with the project have to be shared.
- A larger project achieves economies of scale that several smaller projects will not achieve.
- Legal and accounting rules stipulate a maximum equity position per sponsor, above which the project company will be considered a subsidiary; defining the limit of individual sponsors.

Project Finance

3/4

- A team or consortium of private firms establish a new project company to build, own and operate a specific infrastructure project. The new project company is capitalised with equity contributions from each of the sponsors.
- The project company borrows funds from lenders. The lenders look to the projected future revenue stream generated by the project and the project company's assets to repay all loans.
- The host country government does not provide a financial guarantee to lenders; sponsoring firms provide limited guarantees. "Off-Balance-Sheet" financing.

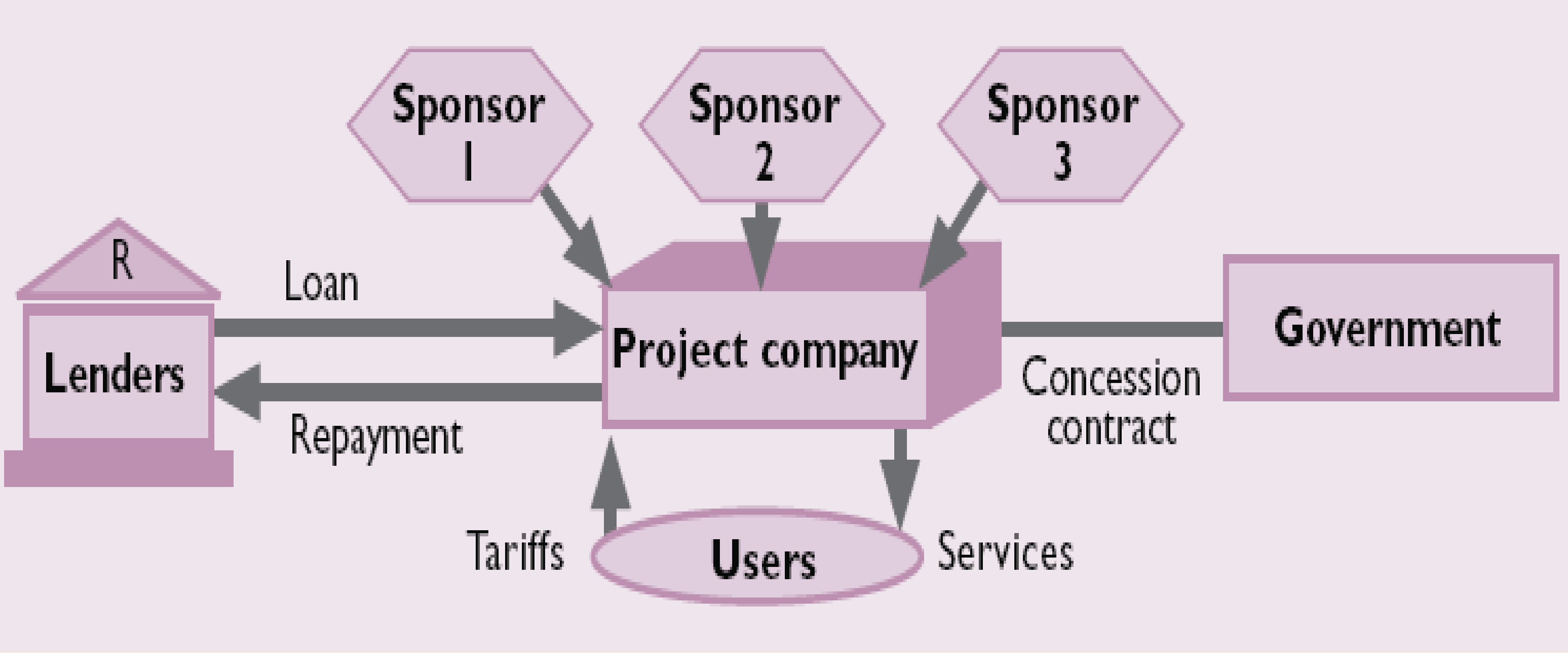
Project Finance

4/4

- In large projects, different legal vehicles may be established to perform specific functions (i.e. construction, maintenance and actual ownership).
- The structure is often dictated by tax and other legal conditions, as well as by the credit implications for each participant.
- In designing the structure of the project, stakeholders should maintain maximum flexibility. In other words, sponsors often have other interests in the project, including the design, construction or management of the project, for which they will establish independent legal entities.
- These relationships will be governed by additional contracts between the project company and the sponsors.
- Sponsors are not precluded from being lenders; this overlap often occurs in practice.

Project Finance Structure

(Source: Project Finance Manual, National Treasury South Africa 2001)



Drivers for Private Finance

- Capital investment required to build modern wastewater treatment plants remains high. Most governments cannot afford such investment, and prefer to use funds for more socially desirable projects.

- Governments and multilateral lending agencies look at private finance as a means to introduce more commercial methods and approaches in the way public utilities are financed and operated, hence improved efficiencies in operations and in cost recovery.

- Private sector finance can reduce the cost of treatment through competition, efficiency, and introducing more integrated solutions at the plant level such as using biosolids to fuel the plants, utilization of grey water, or accessing new revenue schemes such as capitalization on the revenue potential of dry sludge and TSE.

Basic Criteria for PPP

- Enabling framework (legislative, regulatory, political… throughout life of project)
- Well dimensioned, economically relevant project (social economic need, correct investment size, proven technology)
- Responsible reliable public party (decision maker, undertakings, e.g. off-taker, involvement of stakeholders) ……(country/utility ratings)
- Motivated, experienced private party (ability to sustain project-related undertakings, track-record &finances, interest – risk/reward and short term vs long term
- Clear and flexible contract (clear rules, adjustments in the course, benchmark e.g. termination, arbitration, etc.)
- Smart financing structure (efficient management and allocation of risks, FOREX, Packaging security, O&M and EPC

The Project is Bankable once these are met

Alternate Methods of Finance

	Source		Contract
➢ Public Funds	-Budget -Grants -Loans	→	-EPC -Mgt Contract -Lease
➢ Private Funds	-Private banks -M L A	→	-BOO/ BOT -Concession

THANK YOU

FOR NOW

References

Mainly: Project Finance Manual, Version1, National Treasury, South Africa, 2001

Also: UNEP Publications on MDG Goals

Others: As shown