TrainingByteSize

Public Private Partnerships

Project financing and structuring it through a special purpose vehicle

Notes from a series of presentations
by Maurice Diamond FCPFA CP3P
on PPP's and CP3P Certification

Training ByteSize, in conjunction with Maurice Diamond, have produced a short series of presentations, that are available on YouTube. This document is a hard copy of the notes and slides that were used.

Hi, my name is Martyn Kinch, I'm Chairman at Training ByteSize. Together with Maurice Diamond, our lead PPP and CP3P trainer, we have put together a number of short videos around public private partnerships, which I hope you'll find useful .

Maurice Diamond is a Fellow of the Chartered Institute of Public Finance and Accountancy with extensive UK and international PFI and PPP experience. He has been involved in PPP in its various guises since its inception.

Maurice has advised on PPPs in the UK, Europe, Africa, and Asia for over 20 years and provided coaching, awareness, education and training on PFM (public financial management) and PPP (public private partnerships) for senior civil servants, government ministers, PPP practitioners and the private sector. He is also an accredited CP3P Foundation trainer.

Training Byte Size have been delivering PPP and CP3P training for many years now across the world and have one of the most experienced teams available. The CP3P certification program aims to foster a common minimum level of knowledge and understanding amongst individuals working on PPPs or those interests in learning about PPPs, regardless of discipline or sector.

The certification has been designed to create a consistency of terms using PPP and as a process for delivery of PPP projects worldwide, the term PPP, which is, as I mentioned previously, Public Private Partnerships is both used and misused in equal measure. PPP is a useful way for the public sector to renew and develop its infrastructure and economy.

However, there are still many procurement practitioners who do not understand the key differences, to understand a procurement and a PPP. Sometimes this can be the primary cause of PPP procurement failure, either because a feasibility study is flawed and, or the deal has been poorly prepared and presented, and it therefore attract bidders and investors, or it fails to deliver improved value to the taxpayer.

A PPP practitioner not only needs to understand project management, but prior and effective and realistic business cases, undertaking fair, competitive, and transparent procurement and contract management. They also need to understand the key tenants of PPP.

There also many people in the public sector who are not familiar with some of the key features of a PPP, the CP3P qualification, which is sponsored by the world bank and its agencies and accredited by the APMG seeks to overcome this problem.

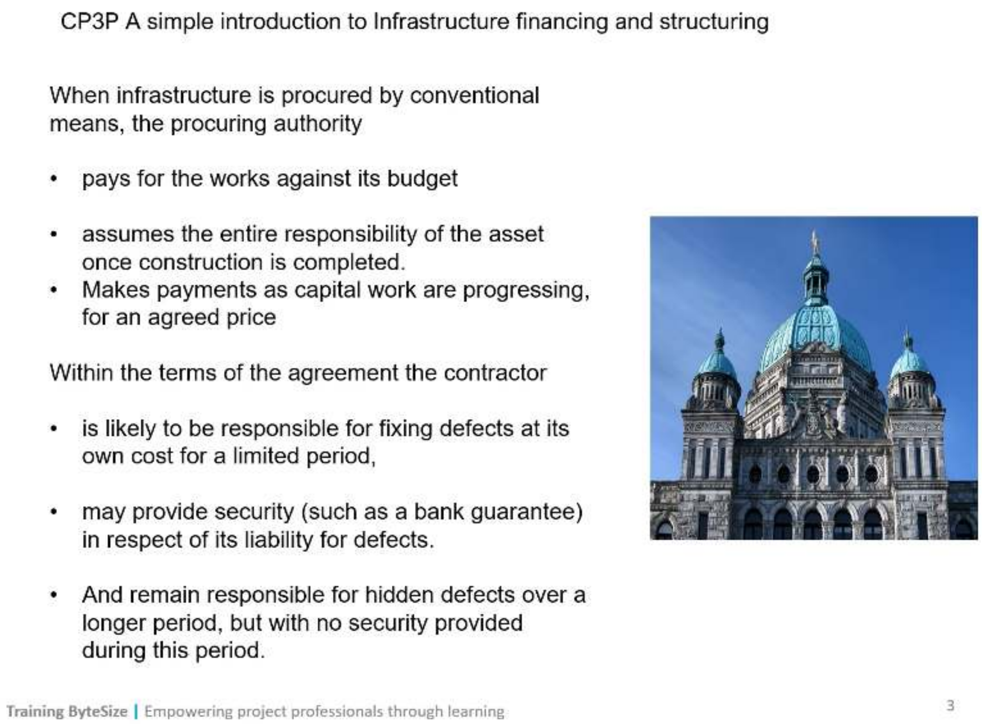
This series of short talks focuses on these areas of the APMG syllabus that make a difference.

The first three in the series, focus on a basic introduction to infrastructure financing and restructuring, structuring cash flows and risk, and the special purpose vehicle financing.

Although these are high level, they provide a good selection of information and insight, you felt you needed, but didn't want to ask. The first one focuses on project finance. It gives a great overview of project financing, PPPs. This is often an area of PPP's that students find difficult to understand. So this will benefit anyone going on a CP3P course or taking the certification exam.

This presentation supports the CP3P qualification and is a simple introduction to infrastructure financing and structuring. In this first document we look specifically at the purpose of project financing and also look at the structuring of it through a special purpose vehicle.

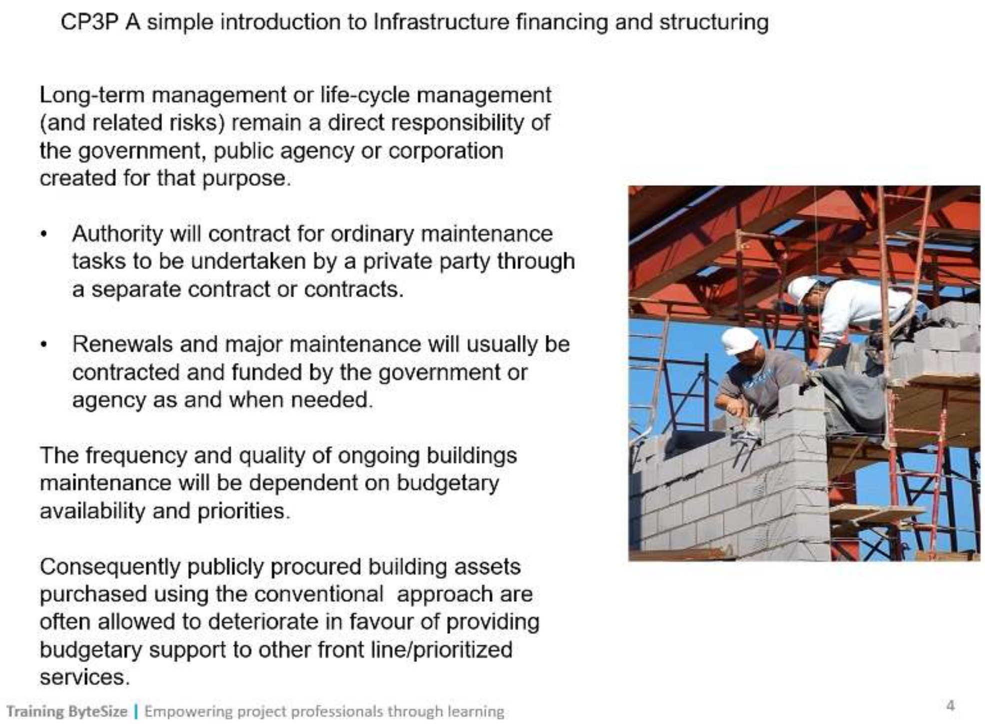
Public infrastructure is a relatively low risk high reward investment, and combining it with complex arrangements and contracts that guarantee and secure the cash flows make PPP projects prime candidates for project financing and the use of special purpose vehicles.



When infrastructure is procured by conventional means, the procuring authority pays for the work against its budget and assumes the entire responsibility of the asset, once construction is completed. Payments are usually made as work is progressing and at the stipulated price or subject to revisions, within the terms of the agreement, the contractor is likely to be responsible for fixing defects at his own cost.

But for a limited period, the contracter may also provide securities such as bank guarantees in respect of its liability for defects . The contractor may also remain responsible for hidden defects over a longer period, but with no security provided during this period.

The authority, usually contracts for ordinary maintenance tasks to be undertaken by a private party through a separate contract or contracts, however long-term management or life cycle management and related risks remain a direct responsibility of the government, public agency or corporation created for that purpose.



Renewables and major maintenance will usually be contracted and funded by the government or agency, as a nd when needed. The frequency and quality of ongoing buildings maintenance will be dependent on budget availability and priorities.

Consequently building assets are often allowed to deteriorate in favor of providing budgetary support to frontline services. Buildings provided under the PPP are part of a service delivery model where the public sector is paying for the availability of the asset and delivery of associated contracted services for the period of the contract, which could be an excess of 30 years.

This means that unless there is a renegotiation of the contract an upfront budgetary commitment is being made at contract signature to fund the services over the life of the contract. And that would not change.

It is a fact that in some countries, public servants prefer to work from a PPP building than one that is procured conventionally, simply because of quality of the office space is effectively maintained, even though in principle, those same people may object to the initiative as a whole.

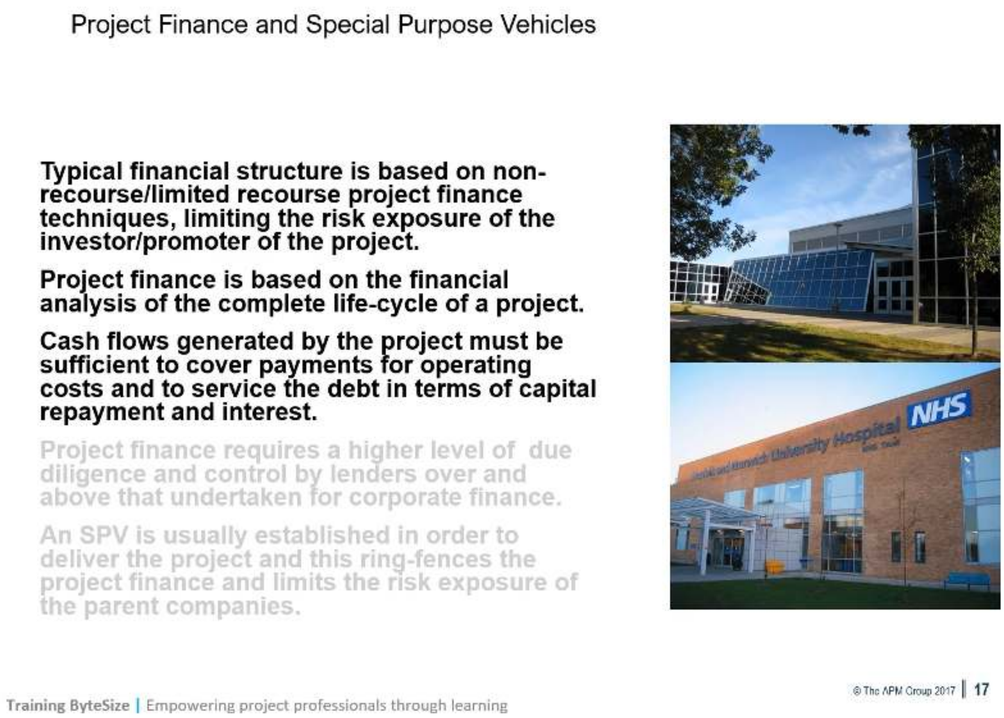
The typical PPP financial structure, is based on non-recourse or limited recourse project finance techniques, limiting the risk exposure of the investor or promoter of the project, the sponsor.

Project finance is based on the financial analysis of the complete life cycle of a project.

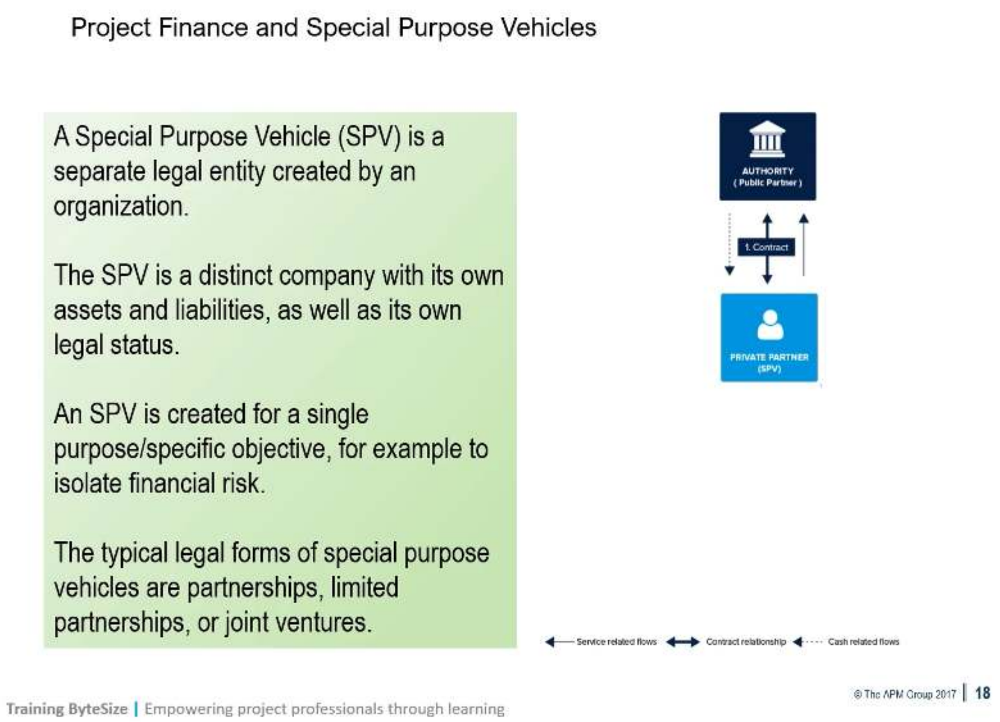
The cash flows generated by the project must be sufficient to cover payments for operating costs and to service the debt in terms of capital repayment and interest.

Project finance requires a higher level of due diligence and control by lenders over and above that undertaken

A for corporate finance. special purpose vehicle or SPV is usually established in order to deliver the project and this ring fences, the project finance and limited the risk exposure of the parent companies.



Let's look at that structure and relationship between the different contracting parties. A special purpose vehicle is a separate legal entity created by an organisation or organisations.

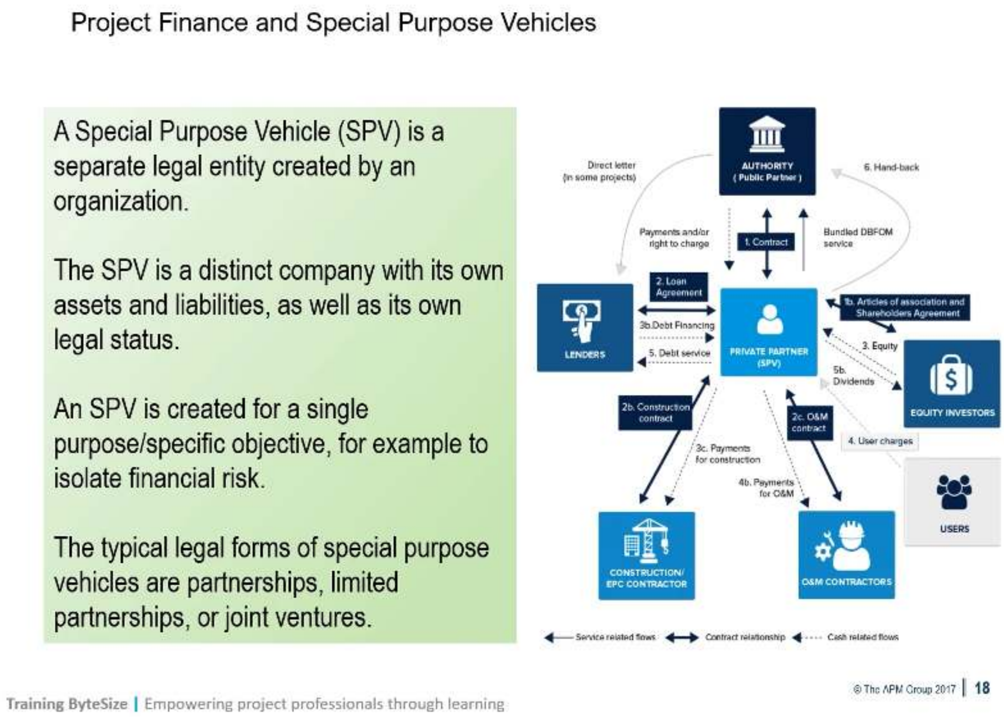


For example, a bidding consortium, the SPV is a distinct company with its own assets and liabilities, as well as its own legal status. It's created for a single purpose or specific objective, for example, to isolate its financial risk.

The typical legal forms of special purpose vehicle are partnerships, limited partnerships or joint ventures. So here we have the authority, the public partner, contracting with the private partner or the SPV and between the two, we have the contract sometimes known as the project agreement.

The SPV or the private partners will comprise of equity shareholders and those equity shareholders, and those equity investors are typically the members of the consortium that bid for the original piece of work, often a building partner and a service delivery partner.

We also then have the lenders who will provide, the loan, so we've got our equity and we have our debt financing. We have a loan agreement between the lenders and the private partner, the SPV.



We may also have what's referred to as a direct letter or a direct agreement between the lenders and the public partner, that sets out the arrangements and ways that certain things will be dealt with under certain circumstances during the life of the contract.

Then right at the bottom, we have the construction EPC contractor and the O&M contractors.

Now they are, as I said before, typically the members of the bidding consortium. So they effectively have at least three roles. They were the bidding consortium. They are now the equity investors in the SPV.

One would hope that as we've done all the due diligence on these companies, and we've decided probably to take them forward as our partner, because of the work that they've done previously elsewhere, and their experience in the field, we would hope that they are going to be the contractors for the SPV.

So interestingly, of course the construction contractor will be paid as they go along during the construction period, and so this will be upfront during the life of the PPP. The O&M contractor will start to receive payment after the services commence, which could be two or three years downstream.

So that's a quick introduction to project finance and special purpose vehicles.

In part two of this presentation, we'll look at cash flows and risk throughout the life of the SPV and the Public Private Partnership.

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