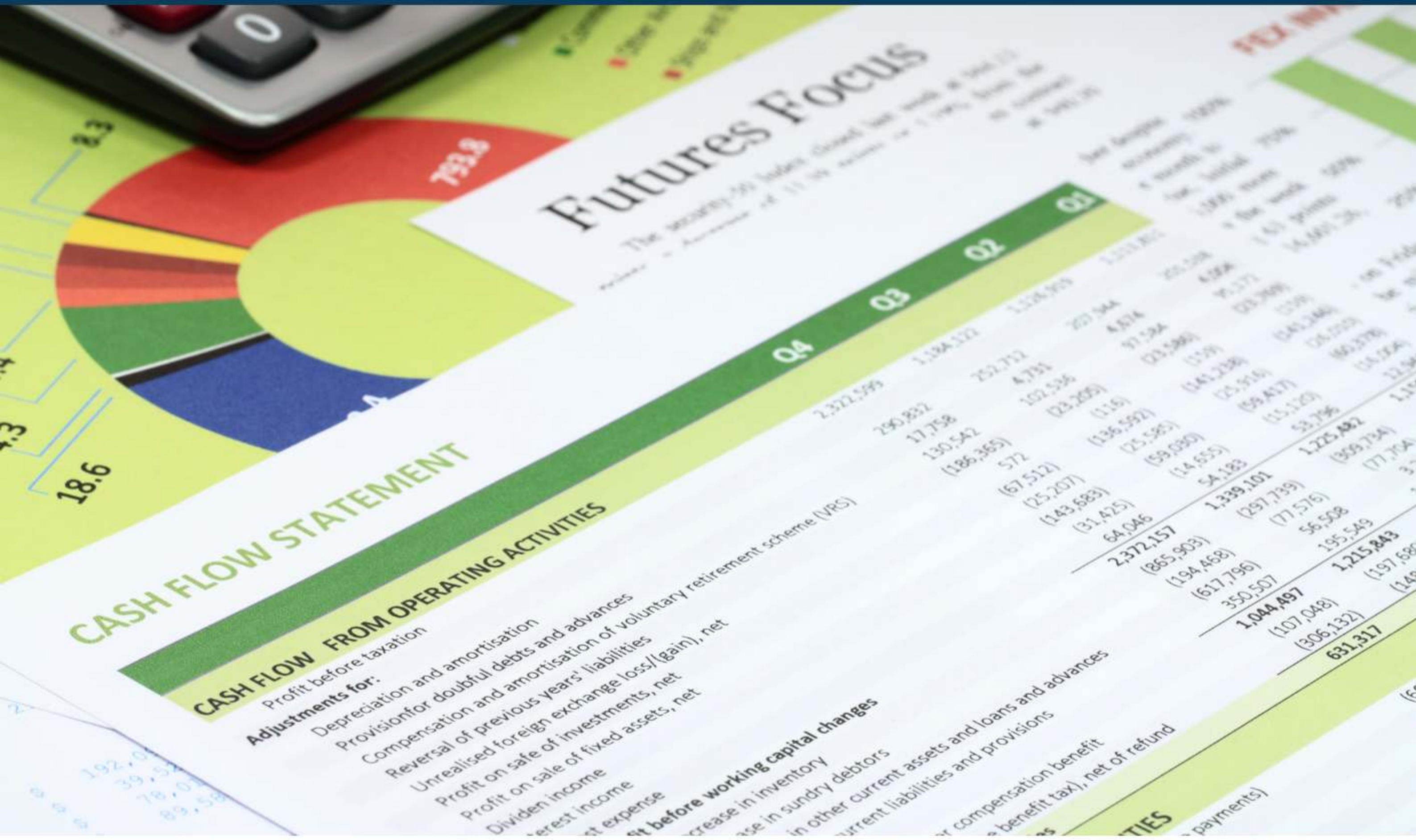
TrainingByteSize

Public Private Partnerships

A simple introduction to infrastructure financing and structuring cash flows



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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.

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.

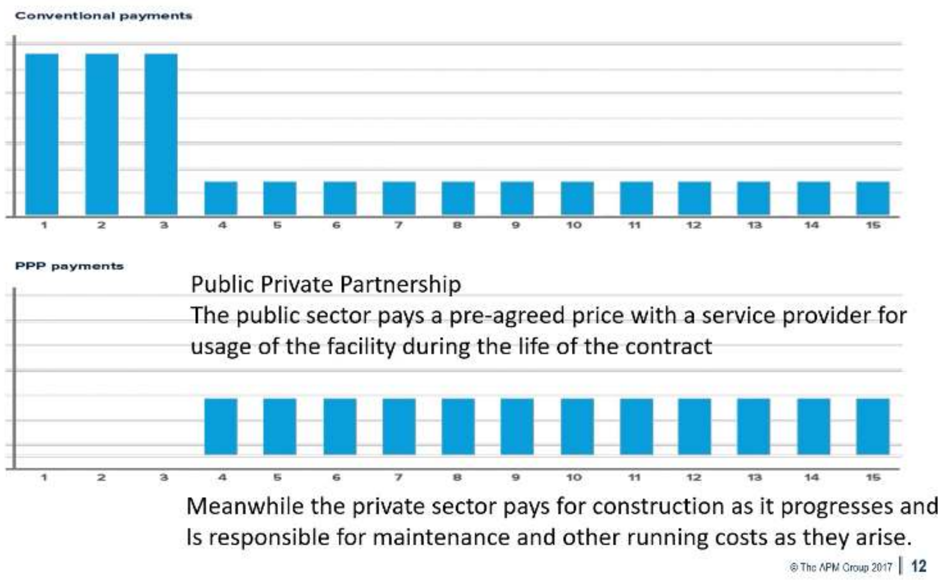
Training Byte Size have been delivering PPP and CP3P training for many years now across the world and have one of the most experienced teams available. The CP3P certification program aims to foster a common minimum level of knowledge and understanding amongst individuals working on PPPs or those interests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

Welcome to the second video in this PPP series, where Maurice looks at a simple introduction to infrastructure financing and structuring cash flows and risk. Maurice walks us through a typical risk profile of a PPP project, which will help illustrate the build and operational period of the project.

This presentation, which supports the CP3P qualification, the qualification for Public Private Partnerships that is accredited by APMG, is a simple introduction to infrastructure financing and structuring, and is in three parts. The first part looked specifically at the purpose of a project financing and also looks at the structuring of it through a special purpose vehicle, this is the second presentation of three, regarding Public Private Partnerships and project finance.

So first of all, let's look at figure 1.8 drawn from the CP3P guide produced by APMG. This is the public sector outflows, and it's a comparative chart between a conventional procurement and a Public Private Partnership. Now under a conventional procurement or traditional procurement, the government pays for construction as it progresses, and then is responsible for maintenance and other running costs as they arise.

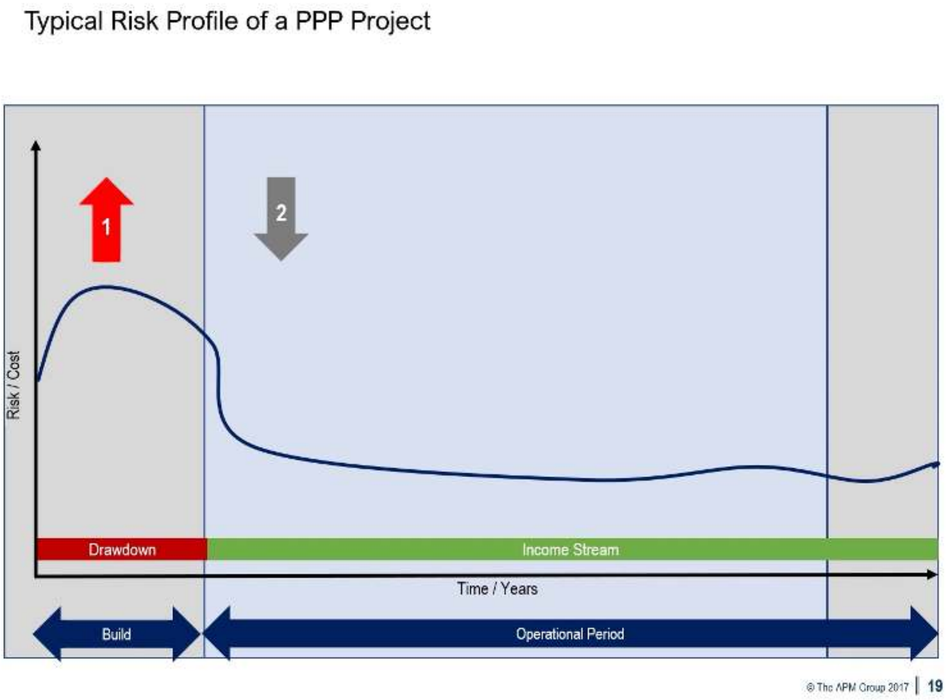
FIGURE 1.8. Public Sector Outflows - Comparative Chart



Under a Public Private Partnership, the public sector pays a pre-agreed price with a service provider for usage of the facility during the life of the contract, and only when the services commence. Meanwhile, the private sector pays for construction as it progresses and is responsible for maintenance and other running costs as they arise.

So we can see here that the amount that the public sector is paying during that period of service operations, is slightly higher than it would be under a conventional procurement. But then on the other hand, the public sector has not made any upfront capital payments. And indeed the quality of that service delivery is what will cause the private sector to be paid.

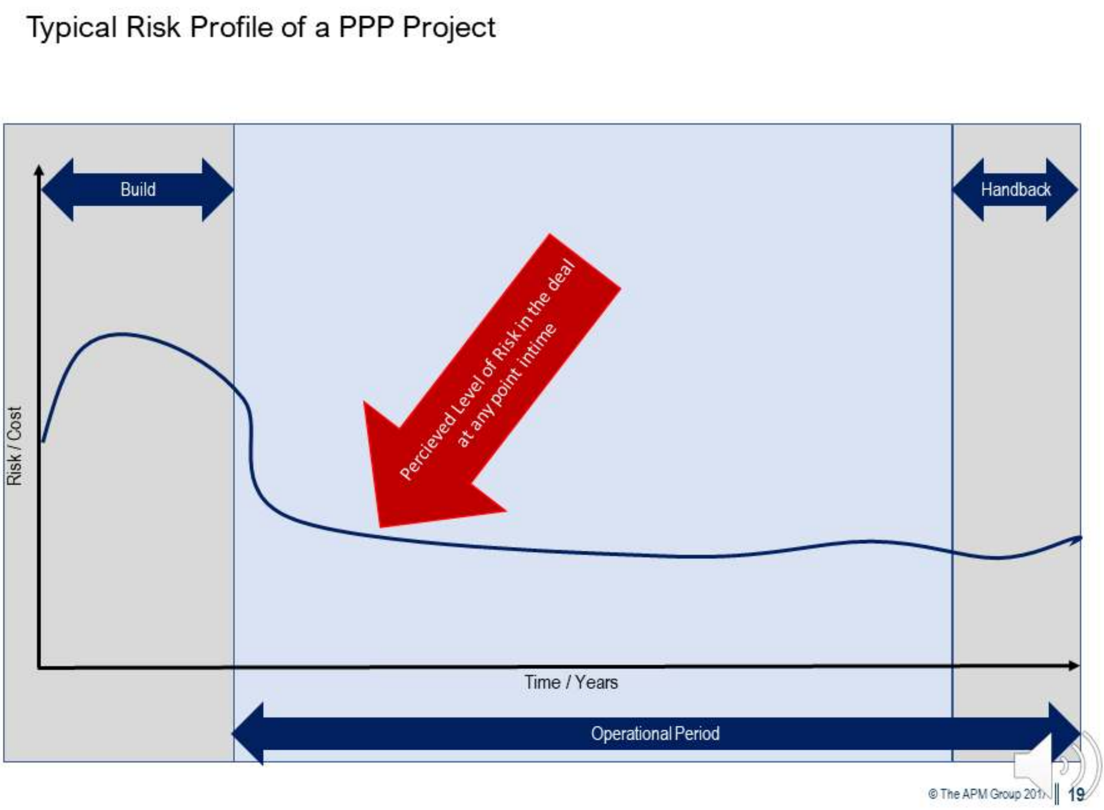
Now, let's look at the risk profile of one of these deals.



So here, we're going to show the risk over time for a typical Public Private Partnership. So we've got risk costs up on the left-hand side, running across the bottom is time or years now. There are effectively two periods for a PPP; one of them is the build phase and that's followed by the operational phase.

However, towards the end of the operational phase, we have a period which is prior to a hundred back before the asset is returned to the public sector. During that period, the private sector SPV, may have to put money into maintaining some of the assets such as a roof and so on. So that becomes a more risky period.

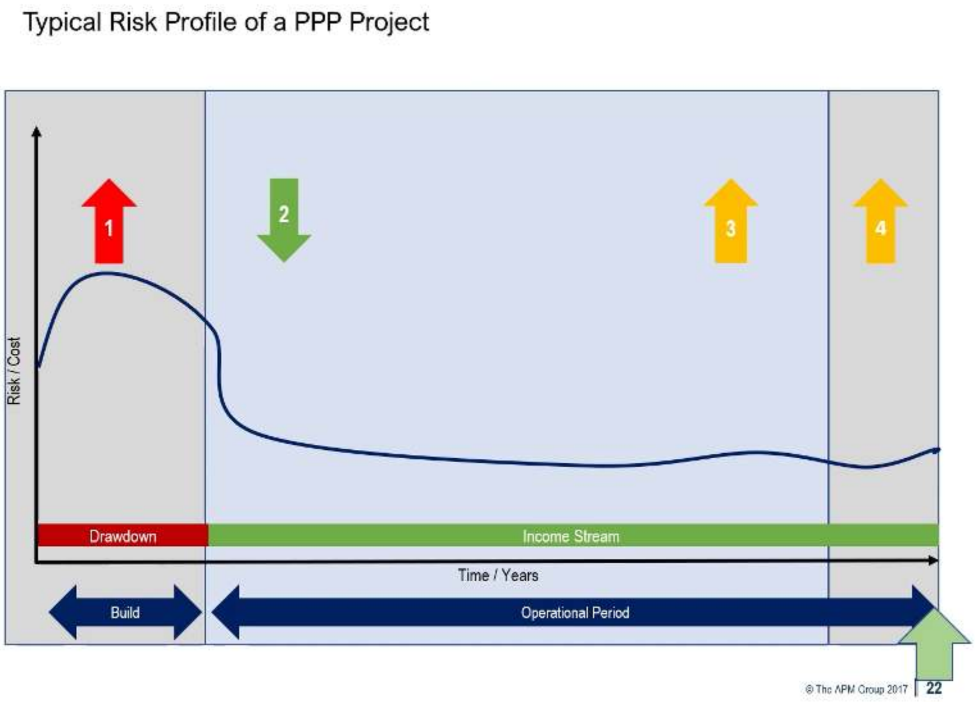
Let's, continue to look at the risk profile of a typical public private partnership.



Here we have the line which is a perceived level of risk in the deal at any point in time, and that is shown as being very high during the first period during that construction period. That's the period during which the SPV will be drawing down its loan from the bank in order to pay it's a building contract.

Then we move into the operational period when the risk falls dramatically, this is the green number two arrow.

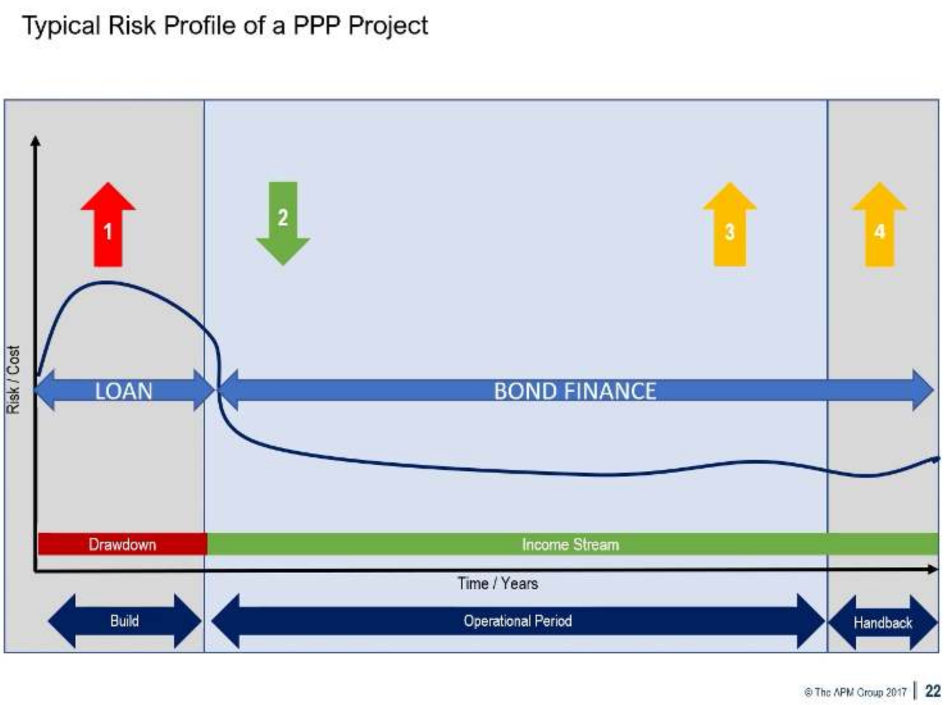
Although initially there might be some additional level of risk associated with setting up the services, setting up the systems associated with the delivery of the contract.



As we move towards the end of the contract period to arrow number three, let's say this was a 25 to 30 year deal. We might be in that period between the 15 and 22, where there'll be a bit of a hump in risk, because we might see that some of our infrastructure might not be operating effectively and might need to be replaced. Of course we will have set aside a maintenance fund as we were going through the each year of the contract to pay for any issues that might arise.

Finally in that handback period which arrow number four indicates, there may be again some additional risk. We know that we're going to call the independent engineer or independent certifier to look at the asset and they will take a view on whether or not there is sufficient life left in certain parts of the asset that had been specified in the contract that go beyond contract term, let's say for three to five years.

If the asset is not sufficiently robust in that way, then the expectation is that the SPV will have to restore let's say the quality of the roof and to put it in good order, at least say that it is sufficiently robust to loss for the period that has been demanded in the contract at the beginning of the contract, maybe 25 or 30 years earlier.



So we have initially the start of our contract where all the risk is ahead of us, those construction, where the risk has dropped considerably. We might now think about refinancing our loan, or perhaps we will have had a three to five year relatively short term loan. And now we are going to be looking at bond finance for the rest of the contract period.

The risk then increases as we move to that mid-life period of the contract. And then ultimately, we get to the end of the contract. Although the risk is maybe increasing, there's a possibility that the asset is in fully good order and the independent certifiers signed it off and we can simply move to term. In which case, if there is a fund that's been put together associated with the maintenance around hand back then that fund can be released to the equity shareholders.

So we could either have low, loan finance, that is throughout the whole period of the contract. Although that actually became quite a difficult to obtain, after the financial crisis in 2007, 2008, more likely we'll see that there will be a loan followed by bond finance as illustrated in the diagram.

Thank you. That brings us to the end of our second seminar in project finance and SPV's. In the next seminar we are going to look at the shareholders of the equity shareholders and debt finances in an SPV.

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