



STRATEGIES FOR PUBLIC TRANSPORT IN CITIES

Public Sector Contracts in PPP structures Senior Lender's perspective

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The European Investment Bank

A policy driven public sector bank

- ❖ European Union's long-term lending bank set up in 1958 by the Treaty of Rome
- ❖ Provides long-term finance for public & private sector projects promoting European integration
- ❖ “Not-for-profit” – support for EU policies
- ❖ AAA financial institution with EUR 164.8 bn of subscribed capital
- ❖ Shareholders: 27 EU Member States
- ❖ 2007 lending activities total 47.8 bn thereof:
 - ❖ the EU – EUR 41.4bn
 - ❖ partner countries – EUR 6.4bn
- ❖ PPP lending volume: over 20 bn



Characteristics of PPPs

- ❖ Considerable legal and structural diversity (eg: DBFO, Management / Operating contracts, leasing etc.)
- ❖ Aim to harness private skills to promote efficiency in delivery of public services
- ❖ Are based on procurement of services, not procurement of assets
- ❖ Incorporate risk sharing arrangements, underpinned by private finance
- ❖ Often, although not always, financed through Project Finance structures
- ❖ Often support very long maturity debt



Key Financing Issues In PPPs

In general

- ❖ Legal and institutional framework
(including security and contractual rights enforcement issues)
- ❖ Political commitment to the PPP and specific project
(including undertakings and obligations within the PPP structure)
- ❖ Competition and availability of PPP partners / participants
- ❖ Transparent procurement process
- ❖ Availability and capacity of LT debt markets and equity providers
- ❖ Appropriate risk and reward balance for public and private sector
- ❖ Public Sector Comparator
(allowing to assess the Value for Money of the PPP for the public sector)



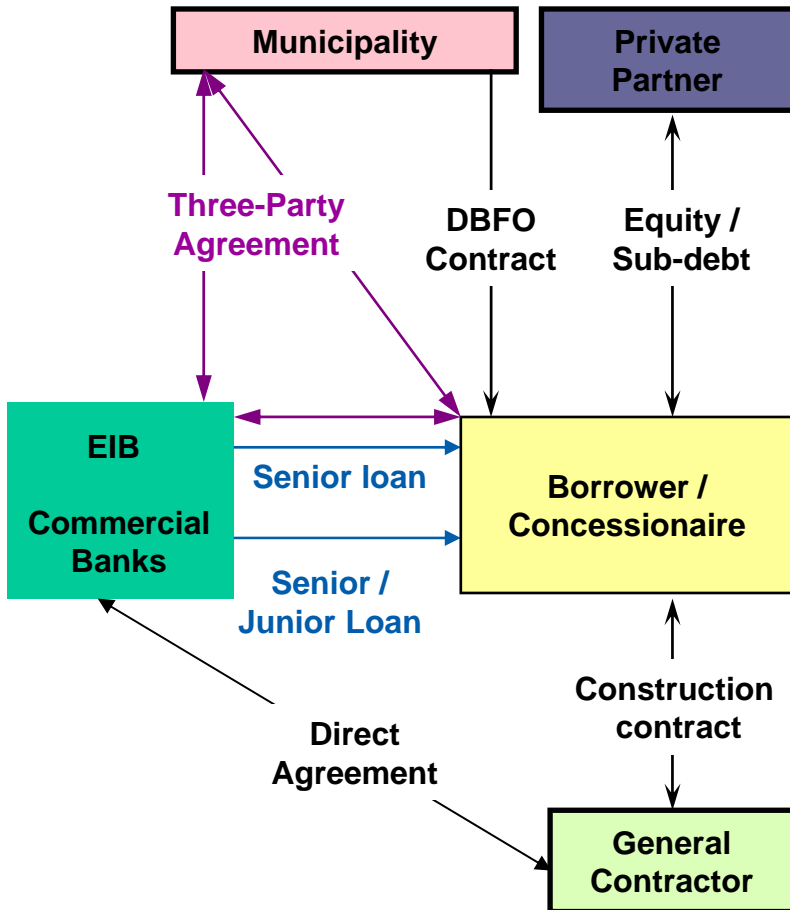
Key Financing Issues In PPPs

Project Related

- ❖ Well defined project, with a clear designation of private partner role and project objectives
- ❖ Experienced and financially strong contractors
- ❖ Proper risk allocation among parties involved
(minimisation of risks retained by the SPV/Borrower - risk should be allocated to the party best able to manage it)
- ❖ Economic and financial viability
(predictable cash flows, reliable financial model and underlying assumptions, adequate liquidity to cover expected and unexpected calls on post opex cash flow and funding for reserve accounts)
- ❖ Availability of alternative suppliers

Municipal transport PPP - French tramway project

No Project risk in operating phase for the Lenders

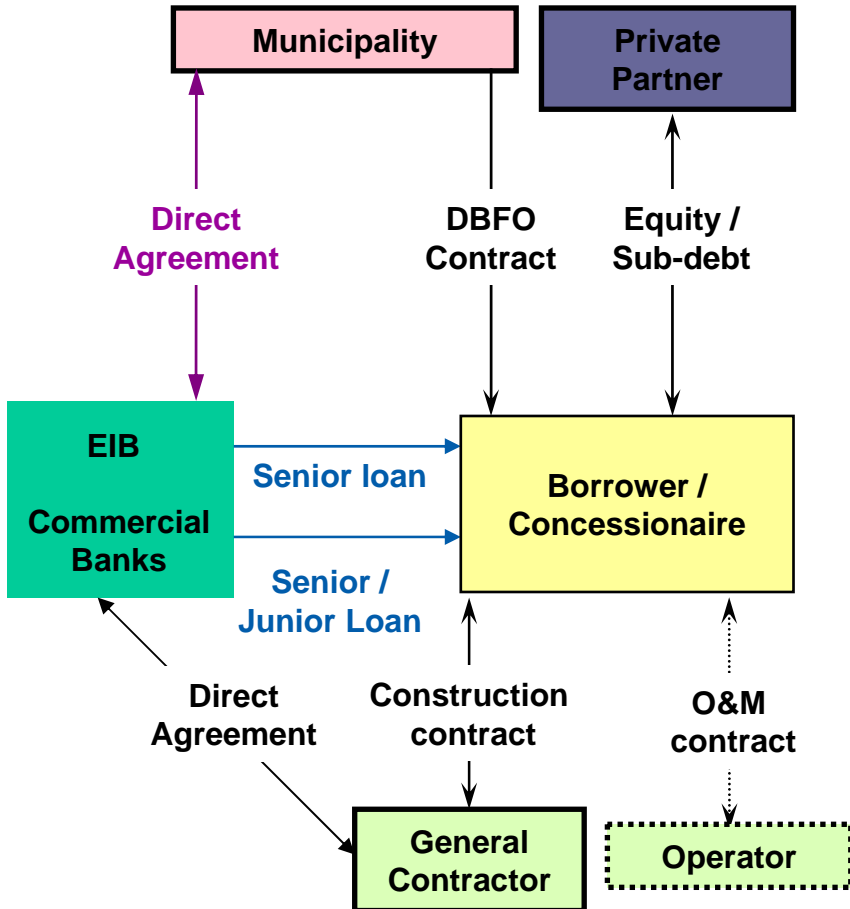


Legal Features:

- ❖ Senior Loan is granted to SPV for construction of the Project
- ❖ The DBFO Contract foresees 2 streams of payments:
 - ❖ Debt coverage
 - ❖ OPEX coverage
- ❖ After Project Completion Borrower's rights to receive the debt coverage payment are irrevocably transferred to the Lenders „*Cession d'Escompte*”
- ❖ Municipality will transfer the money directly to the Lenders to cover all debt service obligations of the SPV
- ❖ SPV will receive payments to cover its operating costs

PPPs – UK model

Lenders exposed to construction & operating risks of the Project



Legal Features:

- ❖ Senior Loan is granted to SPV for construction of the Project
- ❖ SPV may act as an operator or may subcontract it to an O&M Operator
- ❖ SPV receives only one stream of payment under the DBFO Contract
- ❖ Although the rights & proceeds under the DBFO Contract are assigned to the Lenders, they have no direct access to them like in French model
- ❖ Cash Flow Water Fall defines the priority of payments
- ❖ Debt service exposed to changes in revenue or costs of the SPV



Public Sector Contract

What the Lenders will look into? (1/3)

- ❖ **Tenor:** must be longer than tenor of the underlying debt
 - ❖ **Scope of service:** design, construction, operation, maintenance, extension of infrastructure, other
 - ❖ **Payment mechanism:**
 - ❖ is debt service exposed to operating risk of the Project?
 - ❖ is SPV revenue fixed or is it depending on demand, ridership, tariffs?
 - ❖ relation with other operators active on the market
 - ❖ contractual penalties affecting the revenue stream
 - ❖ incentives for improving performance and/or limiting operating costs of SPV
- => is the revenue stream sufficient to provide adequate liquidity i.e. to cover OPEX, debt service, reserve accounts, maintenance CAPEX, free cash and equity return during the whole life of the loan?**



Public Sector Contract

What the Lenders will look into? (2/3)

- ❖ **Contract defaults:** especially those performance related must be precisely defined and provide for reasonable cure periods
- ❖ **Step-in rights:**
 - ❖ unless provided under PSC would be regulated in a separate Direct Agreement between Lenders and Authority
 - ❖ Give Lenders the ability to act to save the project i.e. the Authority relies on Lenders to control the project
- ❖ **Termination:**
 - ❖ voluntary termination by the Authority or due to Authority's default subject to compensation covering usually full debt repayment plus some remuneration of equity
 - ❖ termination due to Private Partner's default => Step-in rights or adequate compensation



Public Sector Contract

What the Lenders will look into? (3/3)

❖ **Insurance:**

- ❖ inability of SPV to take financial losses means risks held by SPV must – to maximum extent possible – be insured
- ❖ What happens if an insured risk becomes uninsurable or insurance costs will be extremely high?

❖ **Force Majeure:**

- ❖ relief from contract termination
- ❖ in some cases partial payments possible
- ❖ Force Majeure Termination – full debt and equity compensation (but no equity return)

❖ **Change of Law:**

- ❖ adequate protection of the SPV, the Project and/or debt service in case changes in law materially and adversely affect the SPV, the Project and its operation.



Conclusions

What do Senior Lenders need?

- ❖ A clear public sector covenant
- ❖ A good understanding of the risks taken on by the private sector
- ❖ Limitation of the risks taken on by borrower
- ❖ Sound insurance arrangements
- ❖ A liquid market in sub-contracted services
- ❖ Step-in rights
- ❖ Appropriate compensation on termination



Senior Lenders

Public Sector's best friend!

- ❖ Senior lender due diligence
 - ❖ Public sector gains some reassurance on deliverability from senior lender due diligence
- ❖ Clear identity of interest with the public sector once project is underway
 - ❖ Good project performance key to lenders being repaid
- ❖ Public sector looks to senior lenders to control the project and deal with problems
 - ❖ Lenders take controls and powers necessary to do this
 - ❖ Public sector should be wary of too 'tight' cover ratios and other financial parameters



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